

# Will Trump Push the Trade War Too Far?

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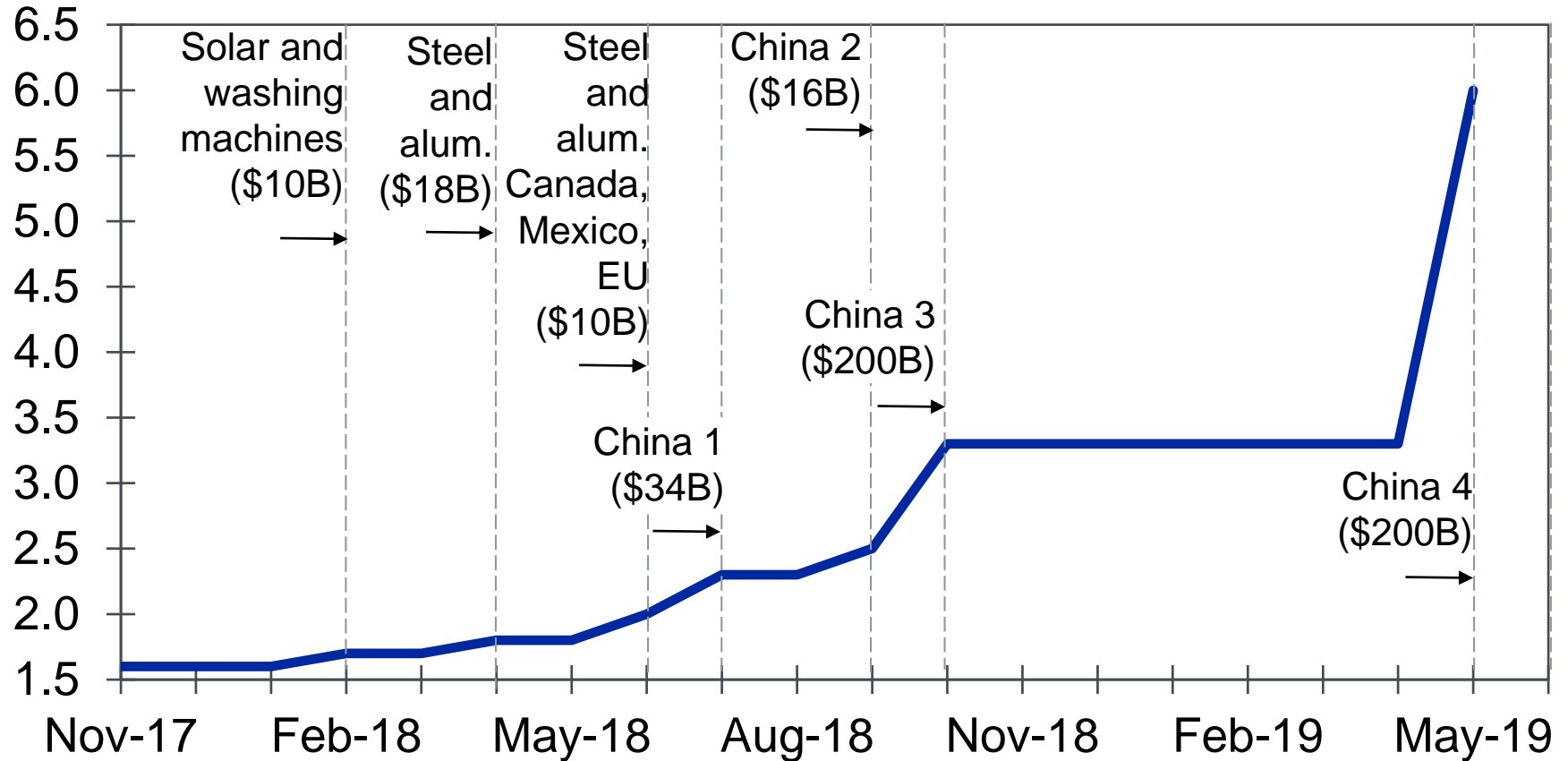
May 28, 2019

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How Did We Get Here?

# The Trade War Escalates

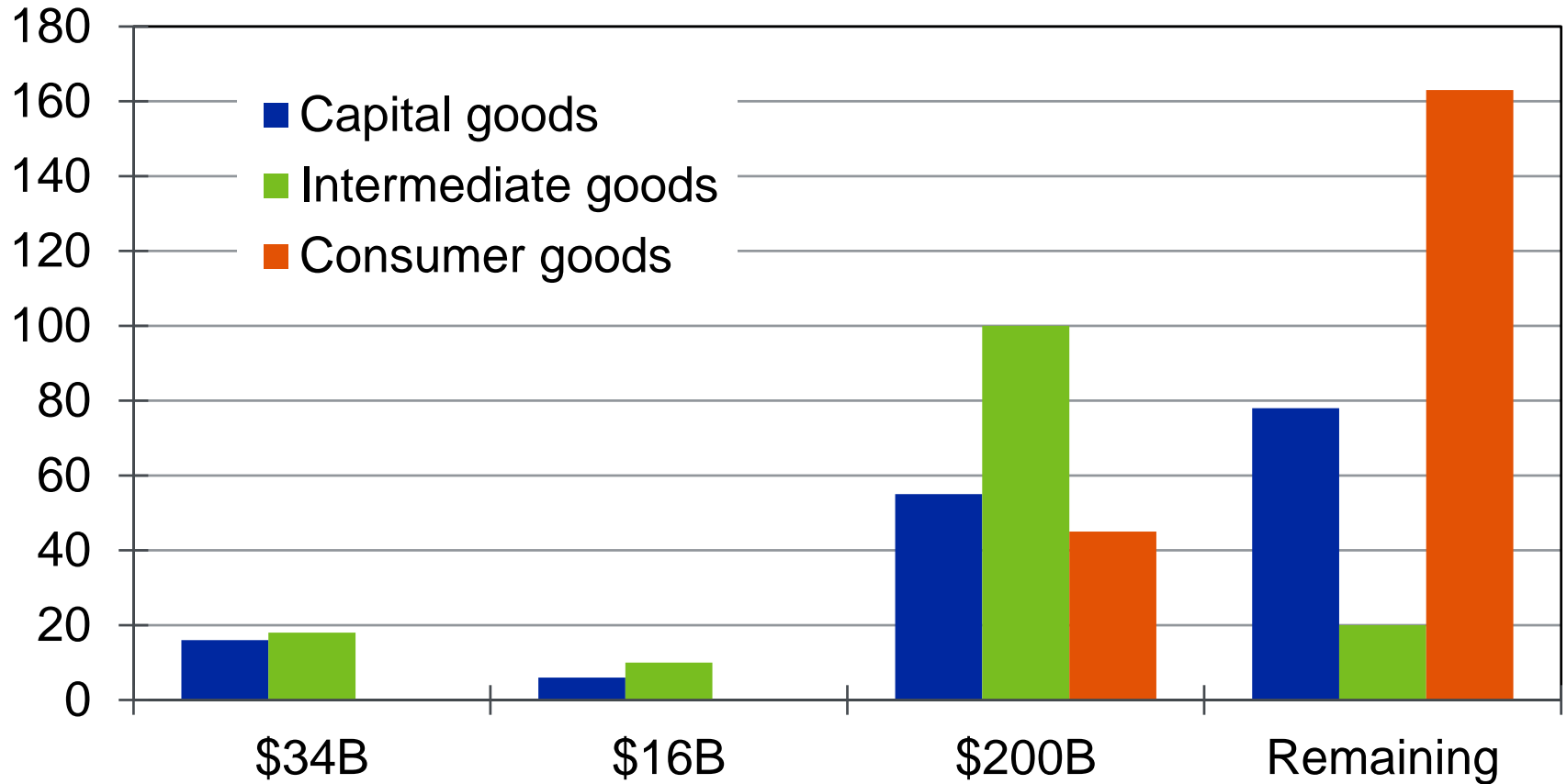
U.S. effective tariff rate, %



Sources: Census Bureau, USTR, USITC, Moody's Analytics

# Who Bears the Brunt of the War

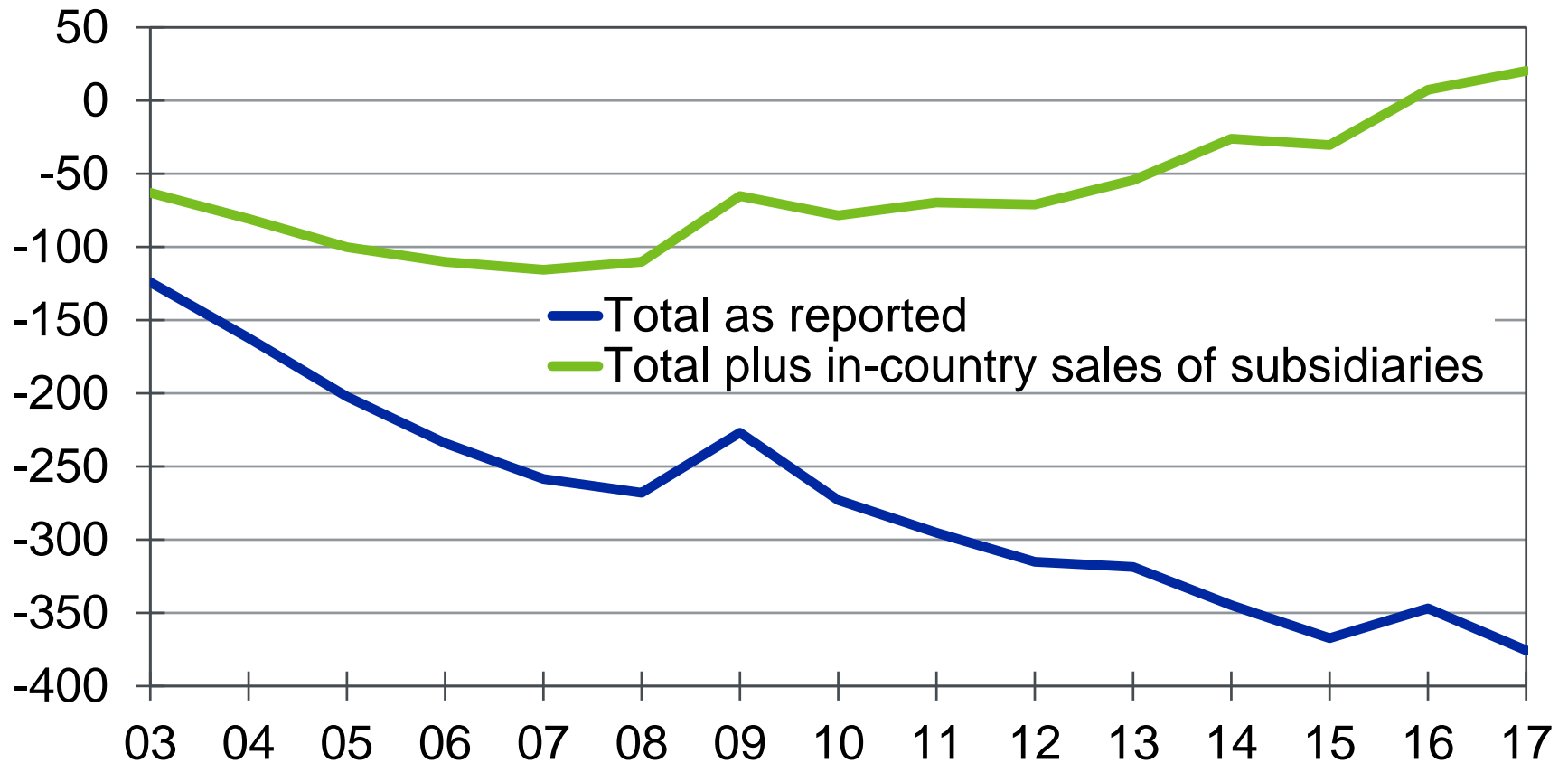
Chinese imported goods subject to tariffs by round, \$ bil



Sources: Commerce Department, Moody's Analytics

# Balanced Trading Relationship

U.S.-China trade balance, \$ bil



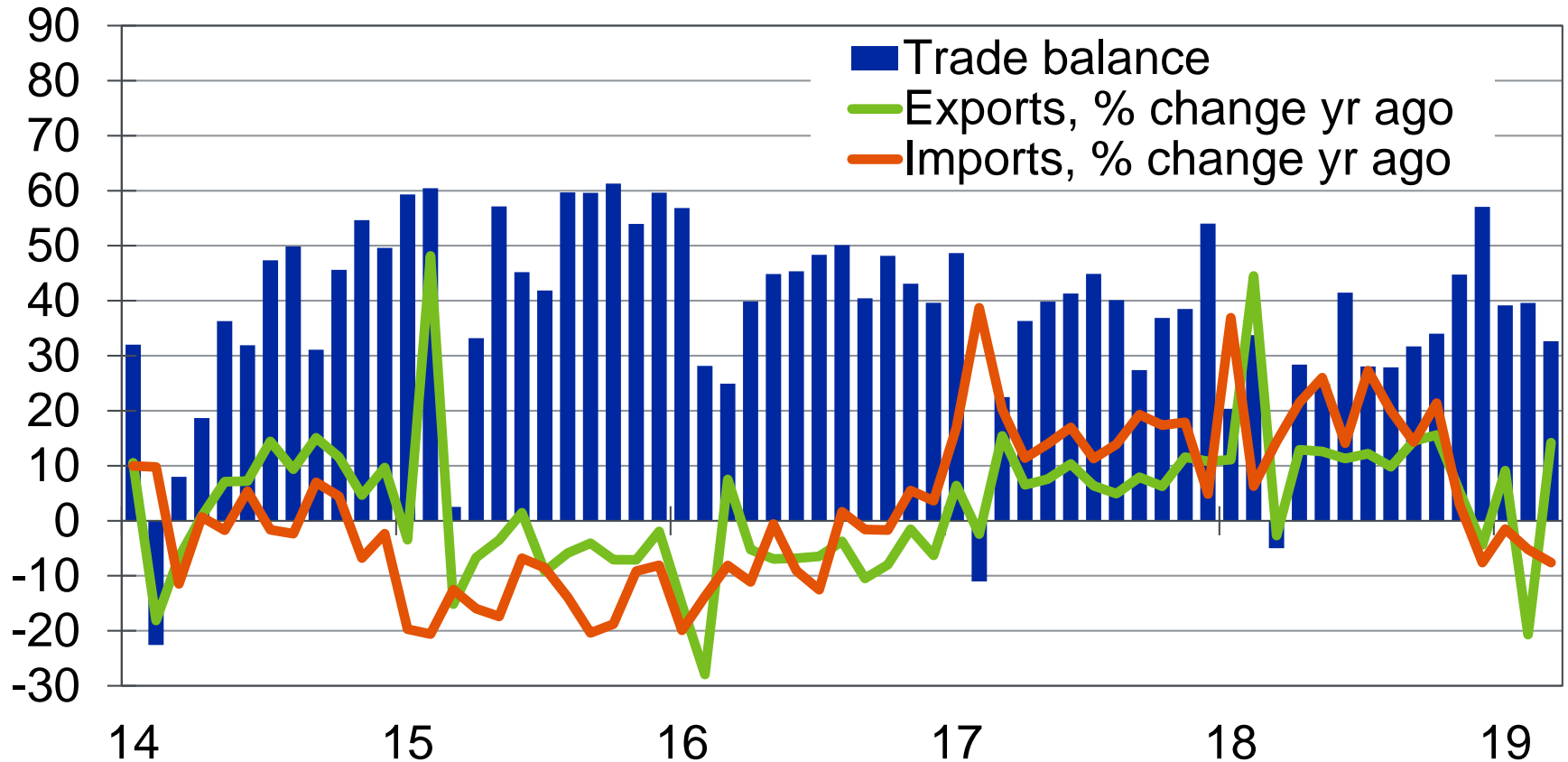
Sources: Census Bureau, Deutsche Bank, Moody's Analytics

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Economic Impact to Date

# China's Trade Engine Has Slowed

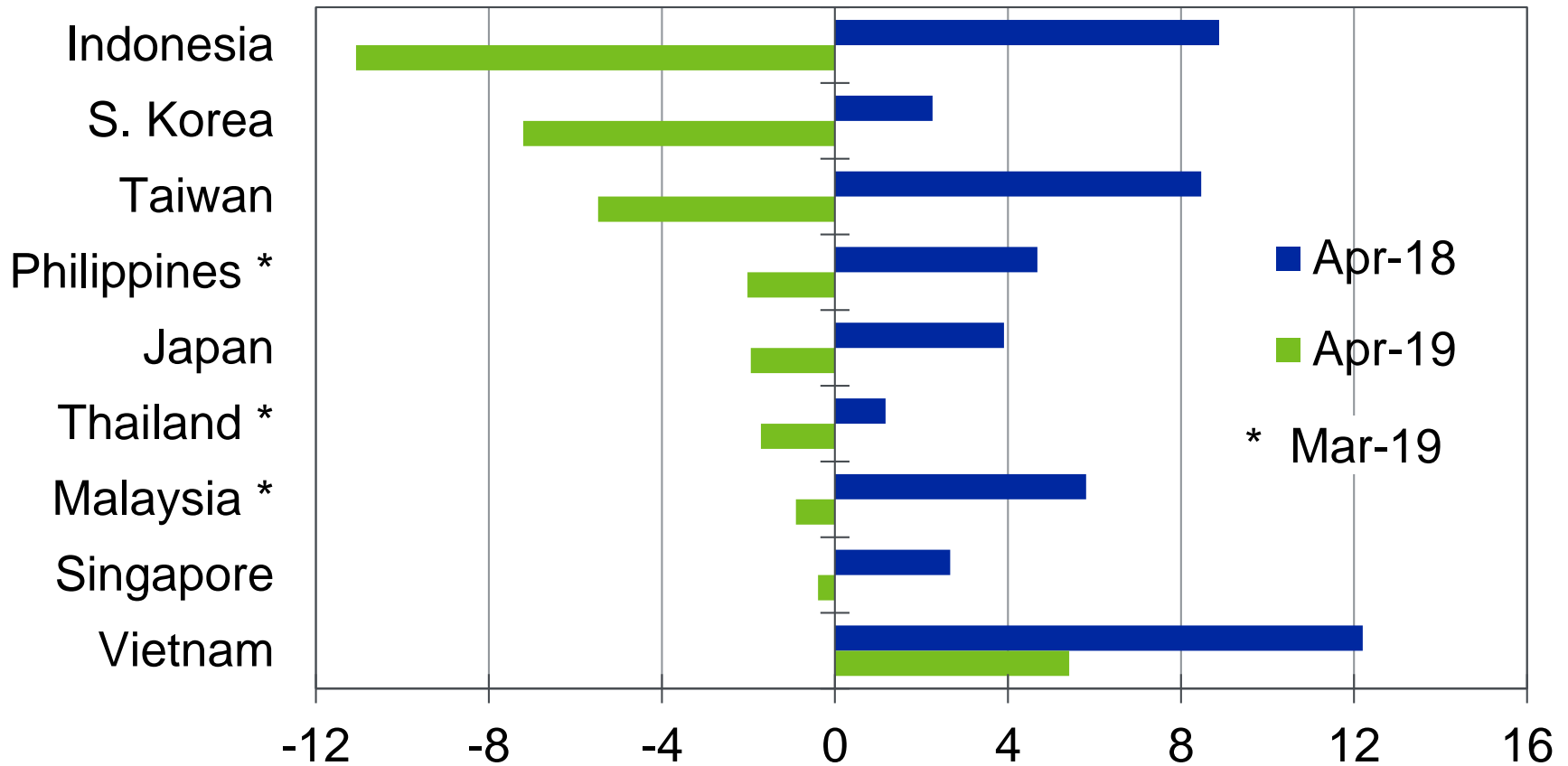
China monthly merchandise trade, US\$ bil



Sources: China Natl. Bureau of Statistics, Moody's Analytics

# Exports Falter Across Asia

Total exports, 3-mo MA, % change yr ago

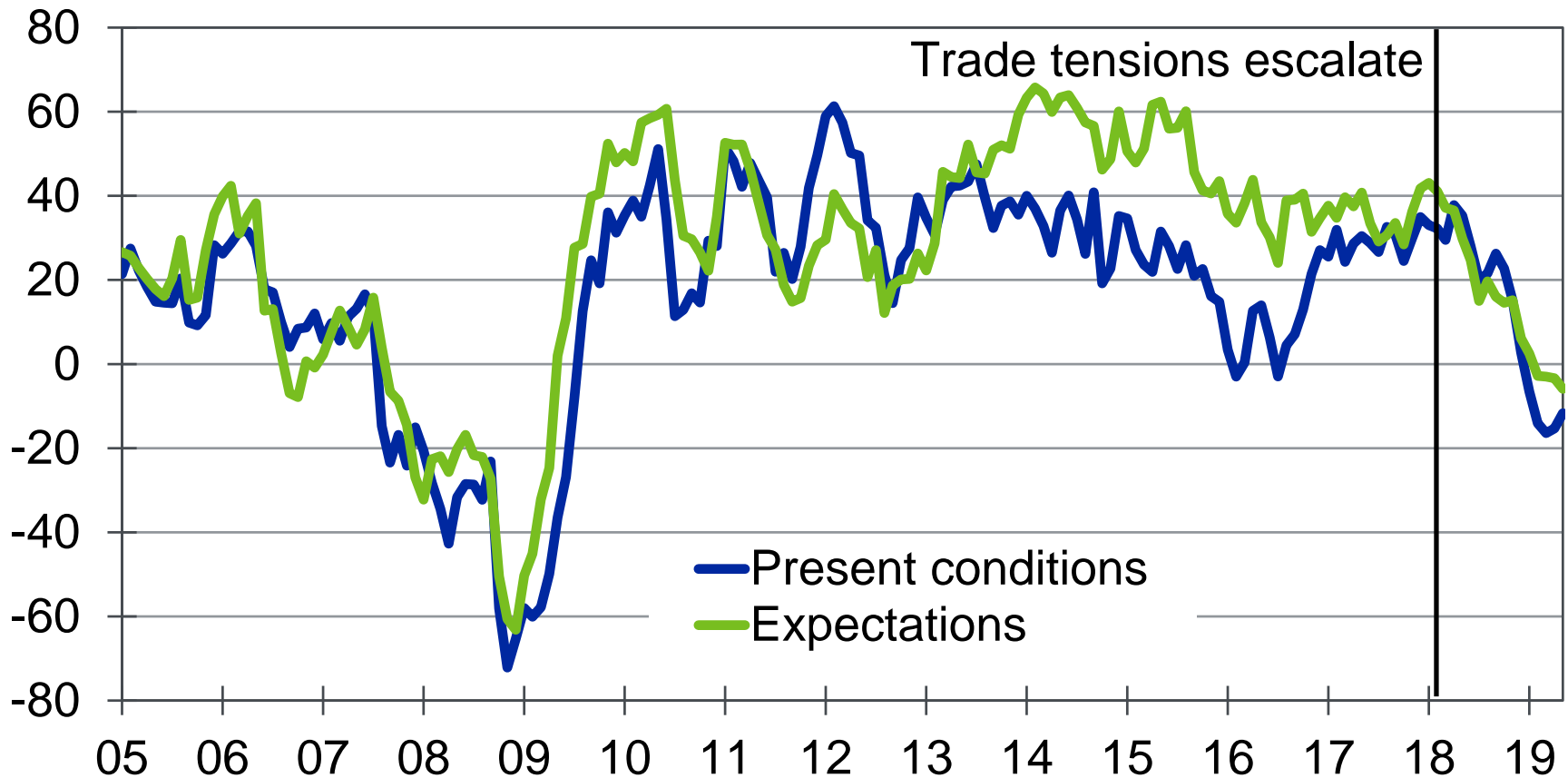


Sources: National statistical agencies, Moody's Analytics



# Trade War Hits Global Business Sentiment

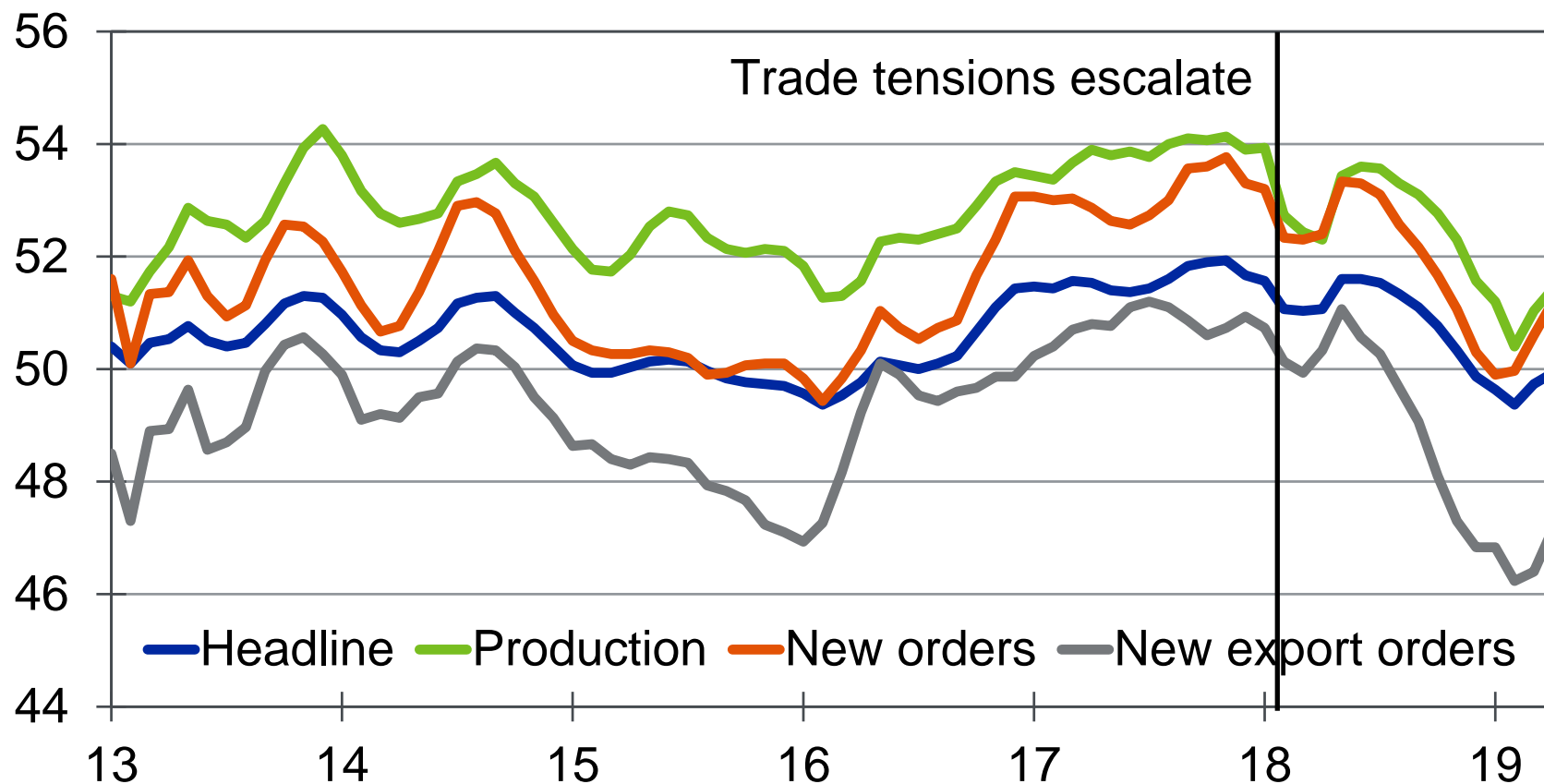
% difference between positive and negative responses



Source: Moody's Analytics

# Some Recent Improvement in China

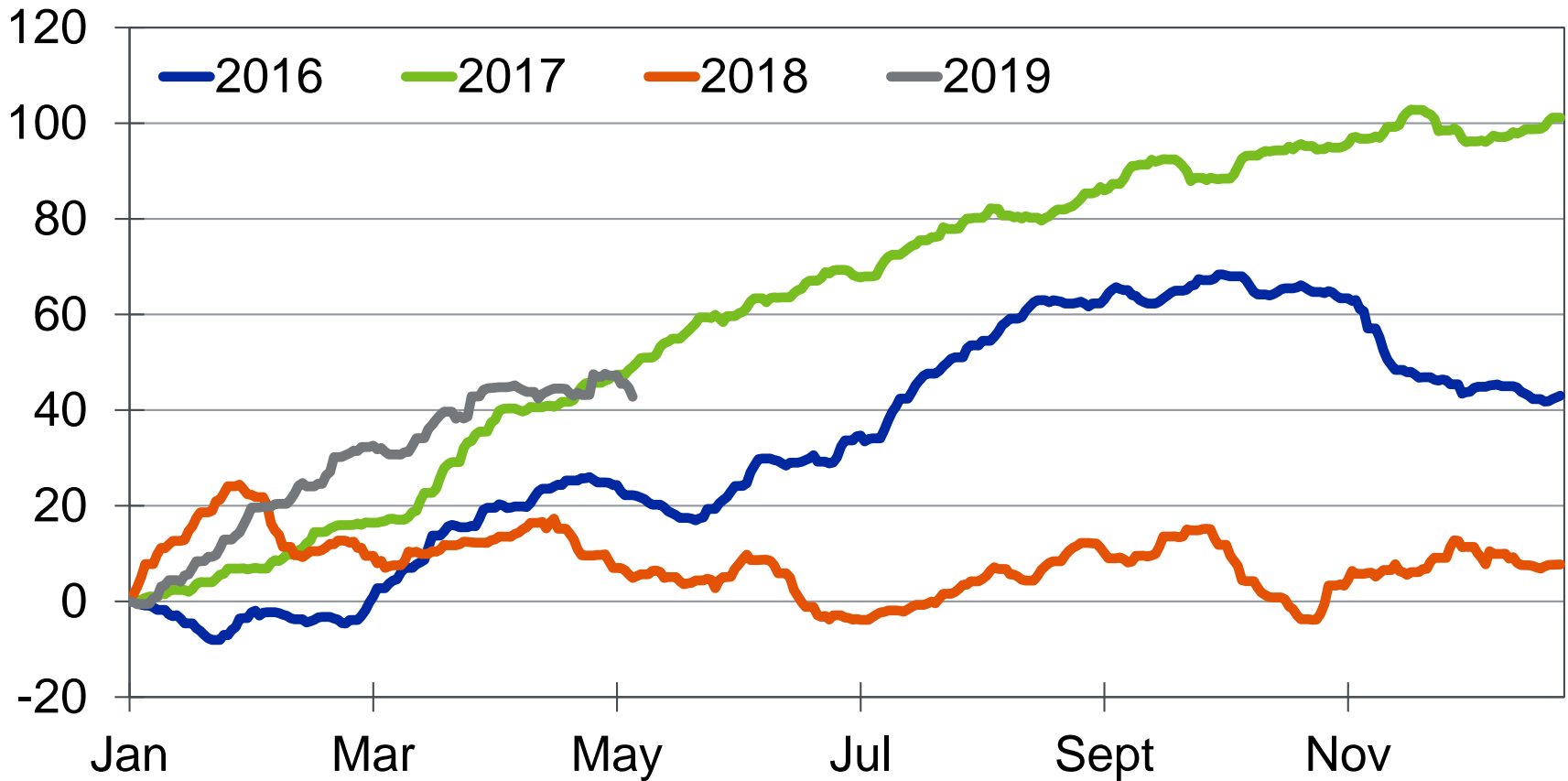
China official manufacturing PMI, 50=neutral, 3-mo MA



Sources: National Bureau of Statistics, Moody's Analytics

# A Better Start to 2019 for EM's

Nonresident cumulative portfolio flows to emerging markets, \$ bil



Sources: Institute of Intl. Finance, Moody's Analytics

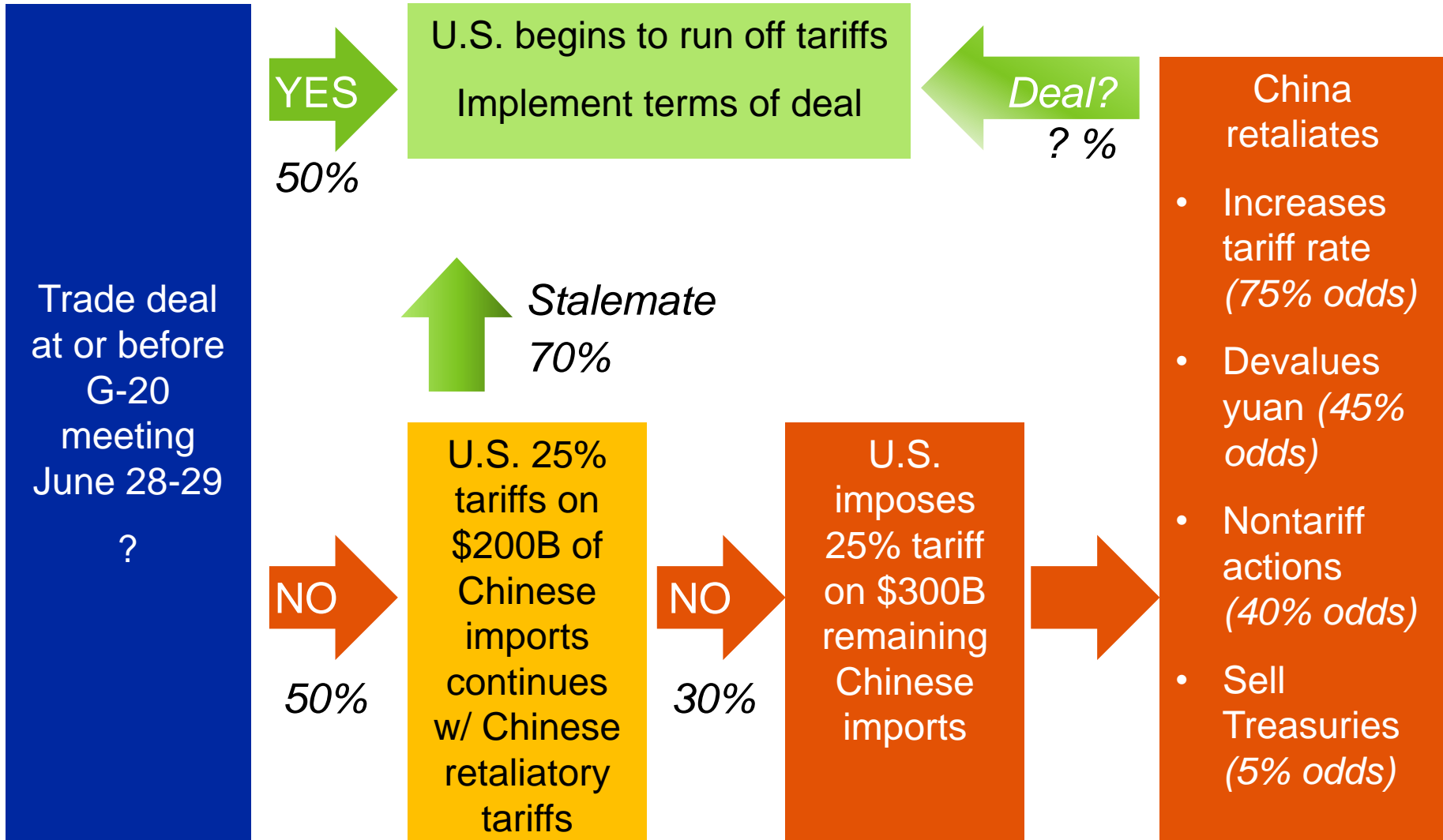
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## Trade War Scenarios

# Possible Scenarios

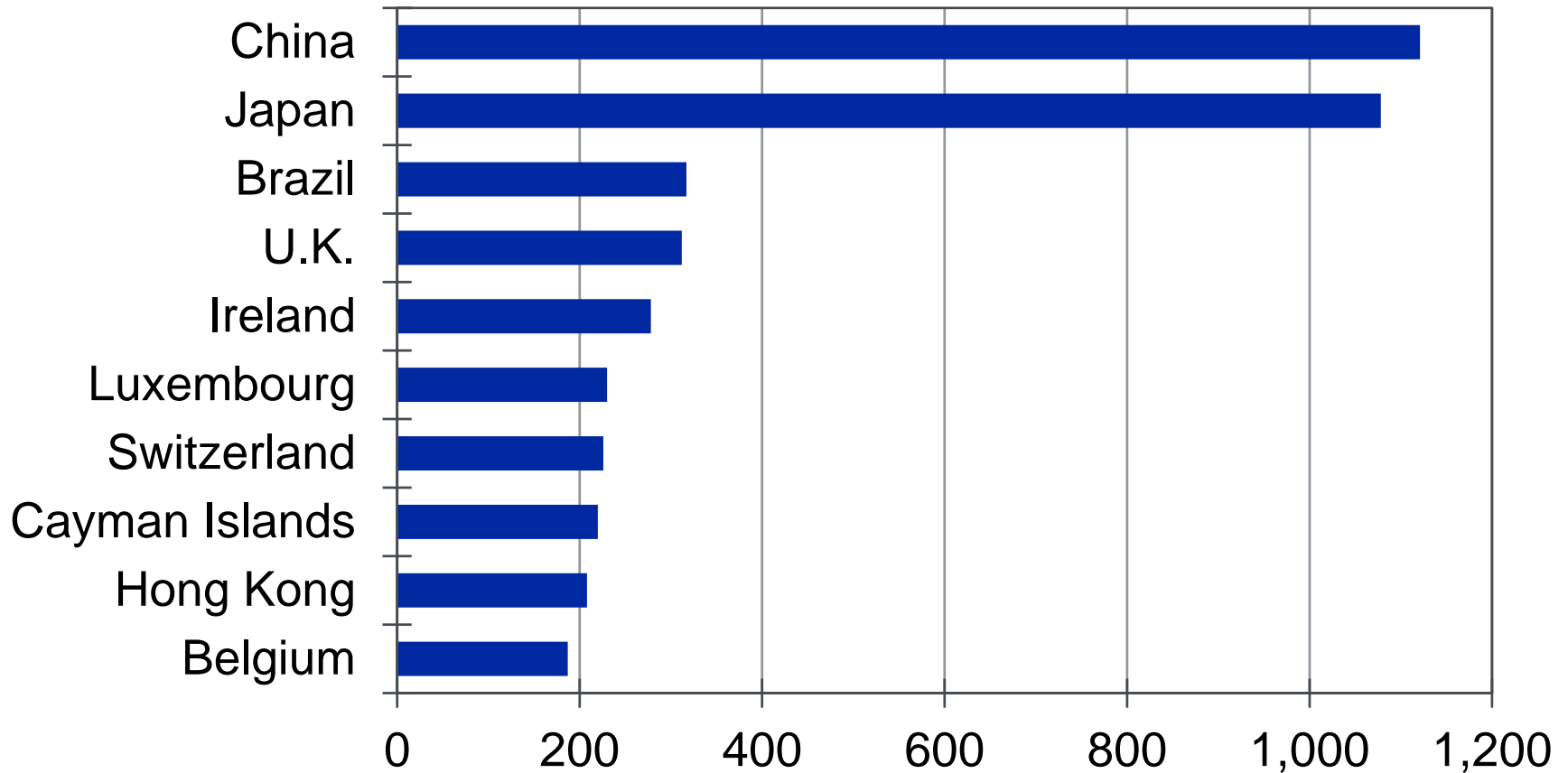
<u>Scenario description</u>	<u>Economic impact</u>	<u>Financial market implications</u>	<u>Value of \$</u>
<p><b>Deal</b></p> <ul style="list-style-type: none"> <li>• U.S and China reach a trade agreement by the end of the G-20 meeting in late June.</li> <li>• U.S. and China agree to run off tariffs</li> </ul>	<ul style="list-style-type: none"> <li>• No change to the baseline.</li> <li>• Potential upside risks as confidence rebounds and supply chain issues fade.</li> </ul>	<ul style="list-style-type: none"> <li>• U.S. and Chinese equity markets rally as unease about the trade tensions is removed.</li> <li>• U.S. 10-year Treasury increases as markets reduce bets of a Fed rate cut.</li> </ul>	<ul style="list-style-type: none"> <li>• U.S. real trade-weighted dollar is little changed.</li> </ul>
<p><b>No Deal – Stalemate</b></p> <ul style="list-style-type: none"> <li>• No deal is struck by the G-20 meeting.</li> <li>• U.S. tariffs remain at 25% on \$200B worth of goods. Chinese retaliatory tariffs in effect.</li> <li>• Tariffs remain in place through Trump’s first term.</li> </ul>	<ul style="list-style-type: none"> <li>• Reduces U.S. GDP growth by 0.5 of a percentage point.</li> <li>• China GDP growth cut by 0.5 of a percentage point, and GDP grows less than 6%.</li> <li>• China pursues additional stimulus.</li> </ul>	<ul style="list-style-type: none"> <li>• U.S. and Chinese equity markets decline.</li> <li>• U.S. 10-year decreases as the term premium falls and markets increase bets on Fed rate cut. Inflation expectations increase, but the impact is modest on long-term rates.</li> </ul>	<ul style="list-style-type: none"> <li>• U.S. real trade-weighted dollar appreciates.</li> <li>• China devalues its currency.</li> </ul>
<p><b>No Deal - Escalation</b></p> <ul style="list-style-type: none"> <li>• Trump puts a 25% tariff on all remaining Chinese imports.</li> <li>• U.S. puts a 25% tariff on all vehicle imports and parts, with exclusions for Mexico and Canada.</li> <li>• Rest of the world retaliates in-kind to the U.S. actions.</li> </ul>	<ul style="list-style-type: none"> <li>• Pushes the U.S. and Chinese economies toward recession.</li> <li>• Global trade flows decline significantly.</li> <li>• The Federal Reserve attempts to cushion the economic blow by cutting rates, and Chinese increase monetary and fiscal stimulus; these efforts fall short.</li> </ul>	<ul style="list-style-type: none"> <li>• U.S. and Chinese equity markets decline sharply.</li> <li>• U.S. 10-year Treasury decreases as the Fed cuts interest rates.</li> <li>• Investor flight to quality further pushes down 10-year yield.</li> </ul>	<ul style="list-style-type: none"> <li>• U.S. real trade-weighted dollar appreciates.</li> <li>• China devalues its currency.</li> </ul>

# Timeline for a Trade Deal or No Deal



# Chinese Have Leverage...

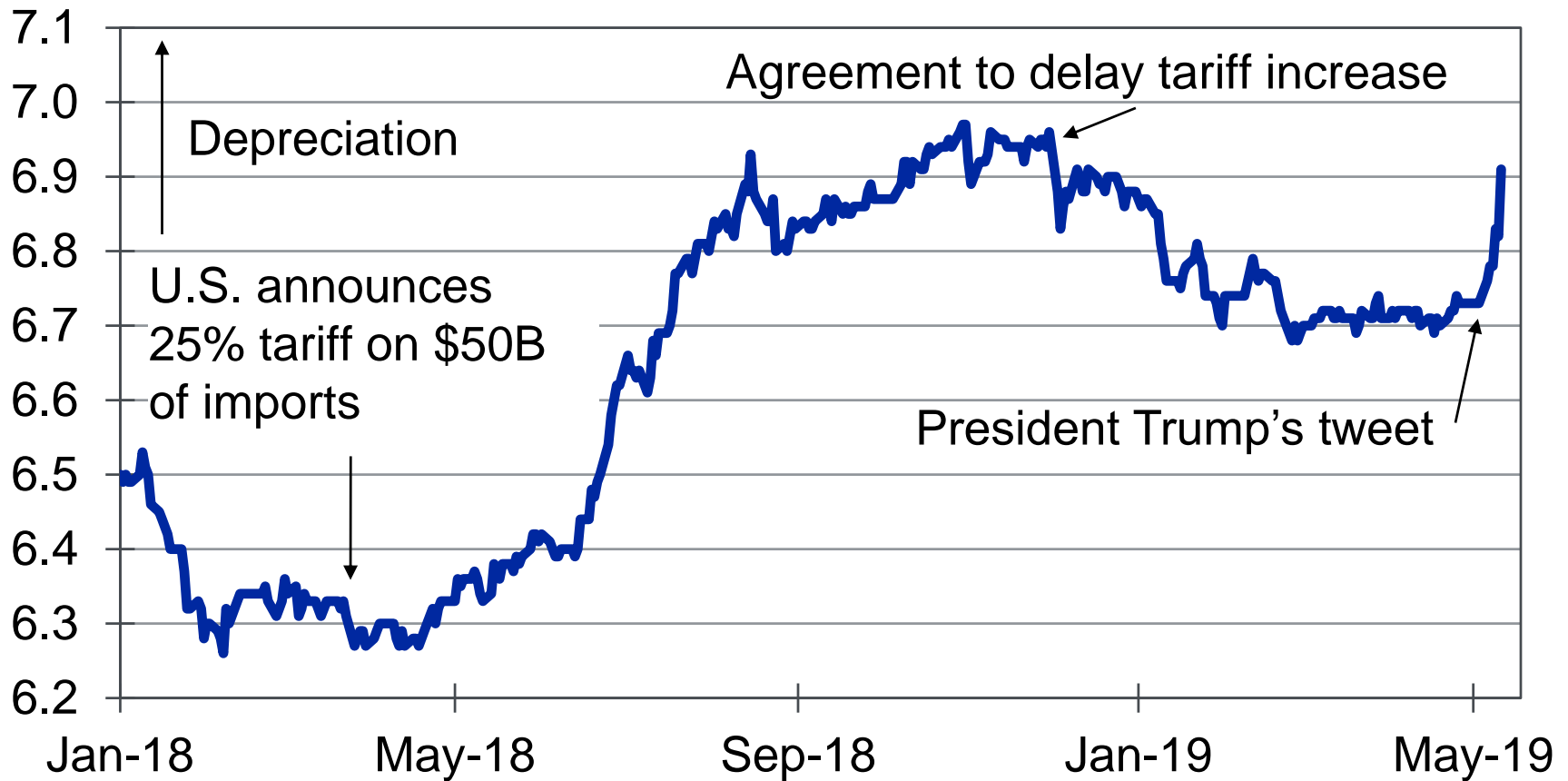
10 largest foreign holders of U.S. Treasuries, \$ bil



Sources: Treasury Department, Moody's Analytics

# ...Significant Leverage

U.S./Renminbi exchange rate

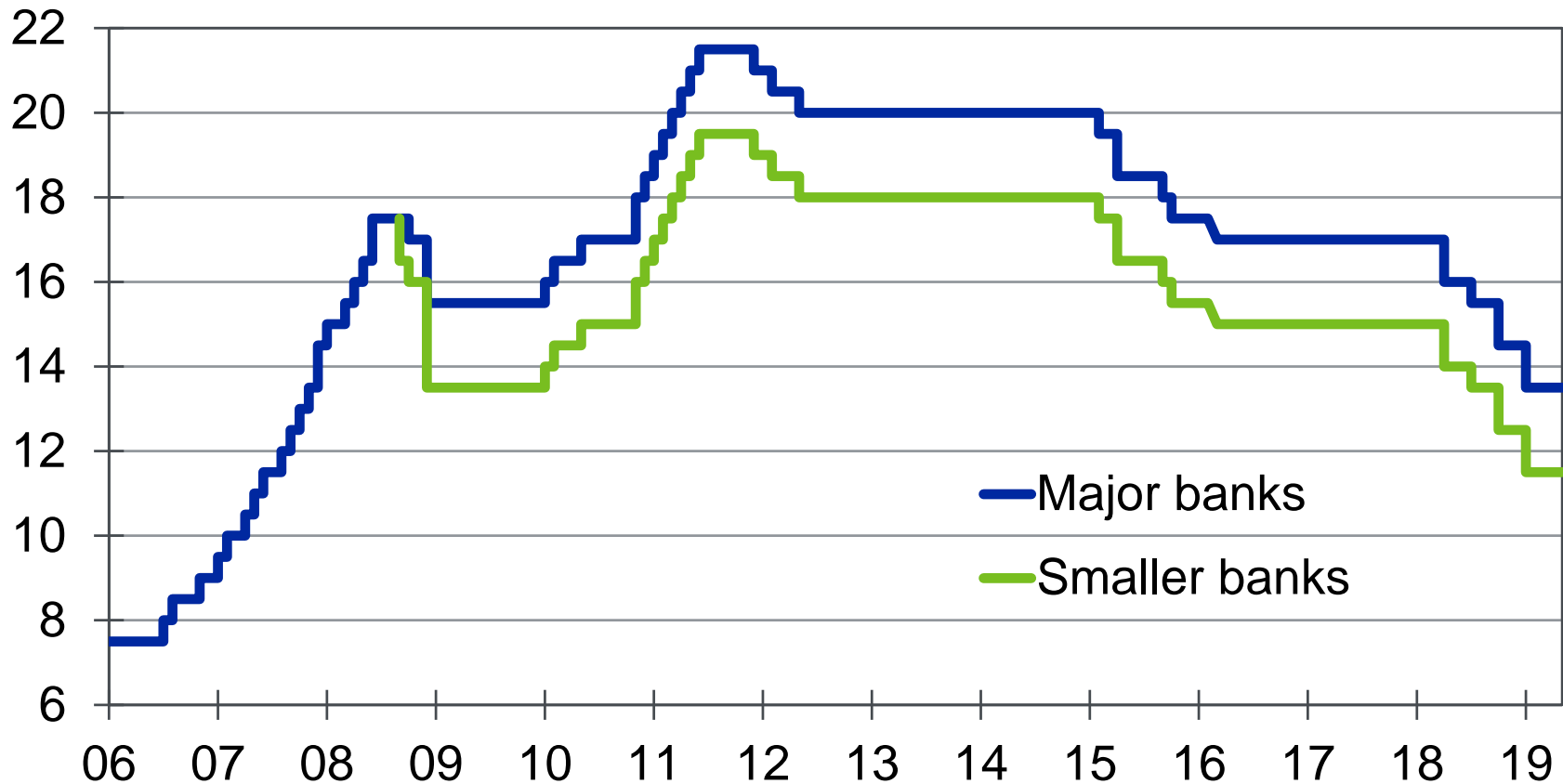


Source: Moody's Analytics



# China Should Be Able to Manage

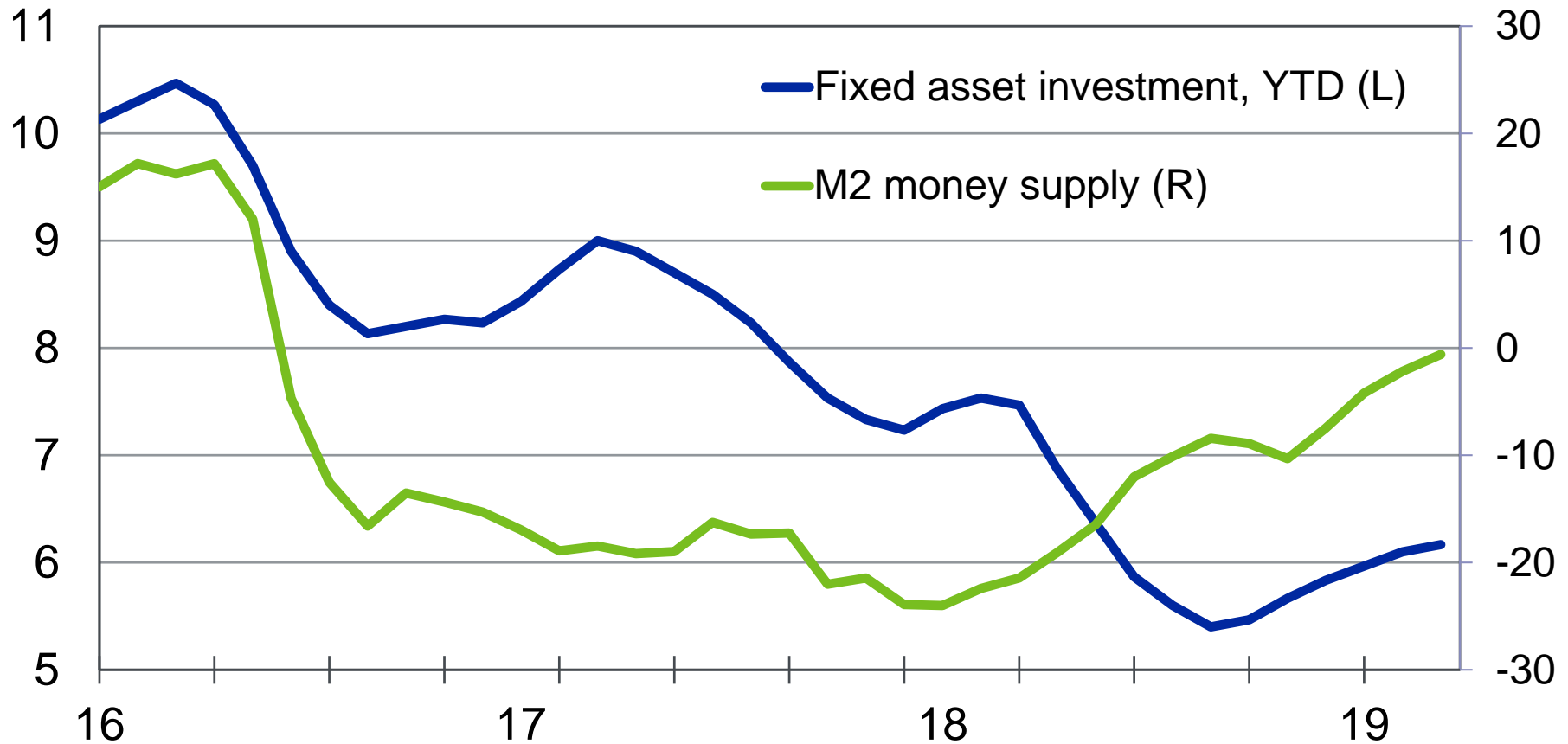
Reserve requirement ratio, %



Sources: People's Bank of China, Moody's Analytics

# Stimulus Bearing Fruit

China's fixed asset investment, % change yr ago YTD, 3-mo MA



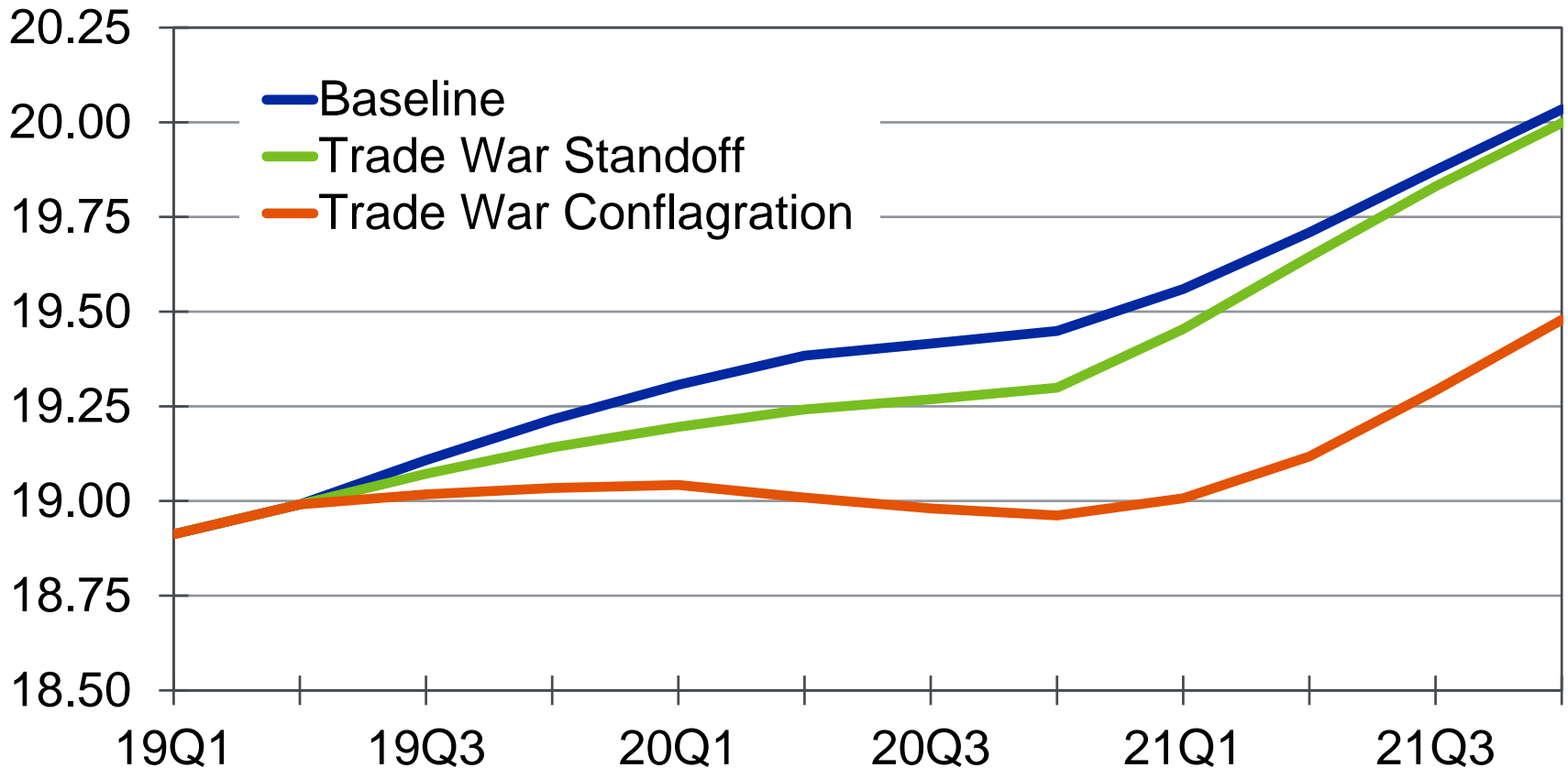
Sources: National Bureau of Statistics, Moody's Analytics

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Trade War Fallout

# Trade War Could Turn Darker...

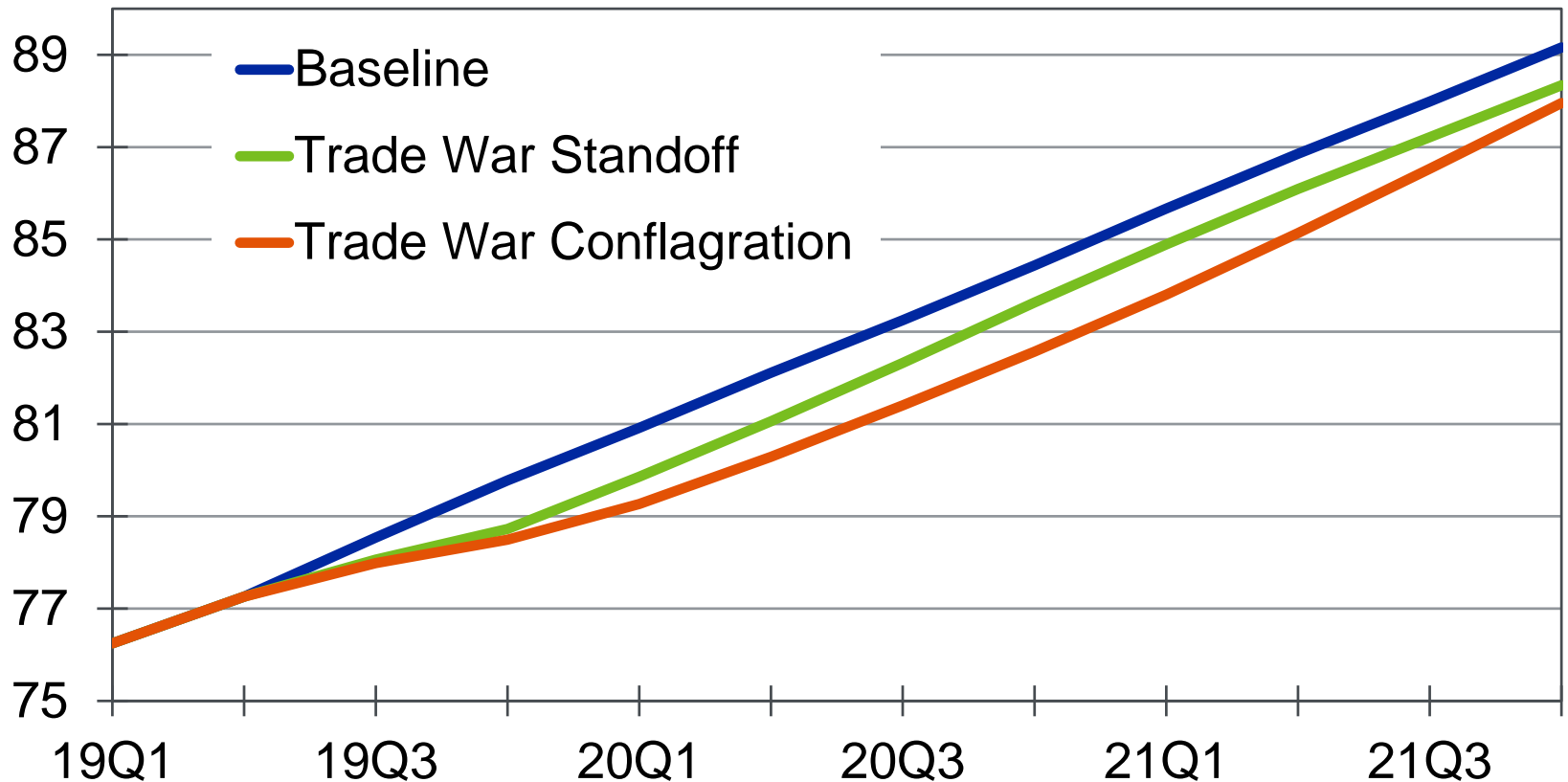
U.S. real GDP, 2012\$ tril



Sources: BEA, Moody's Analytics

# ...Driving A Significant Impact

China real GDP, 2010 CNY bil., SAAR



Sources: National Bureau of Statistics, Moody's Analytics

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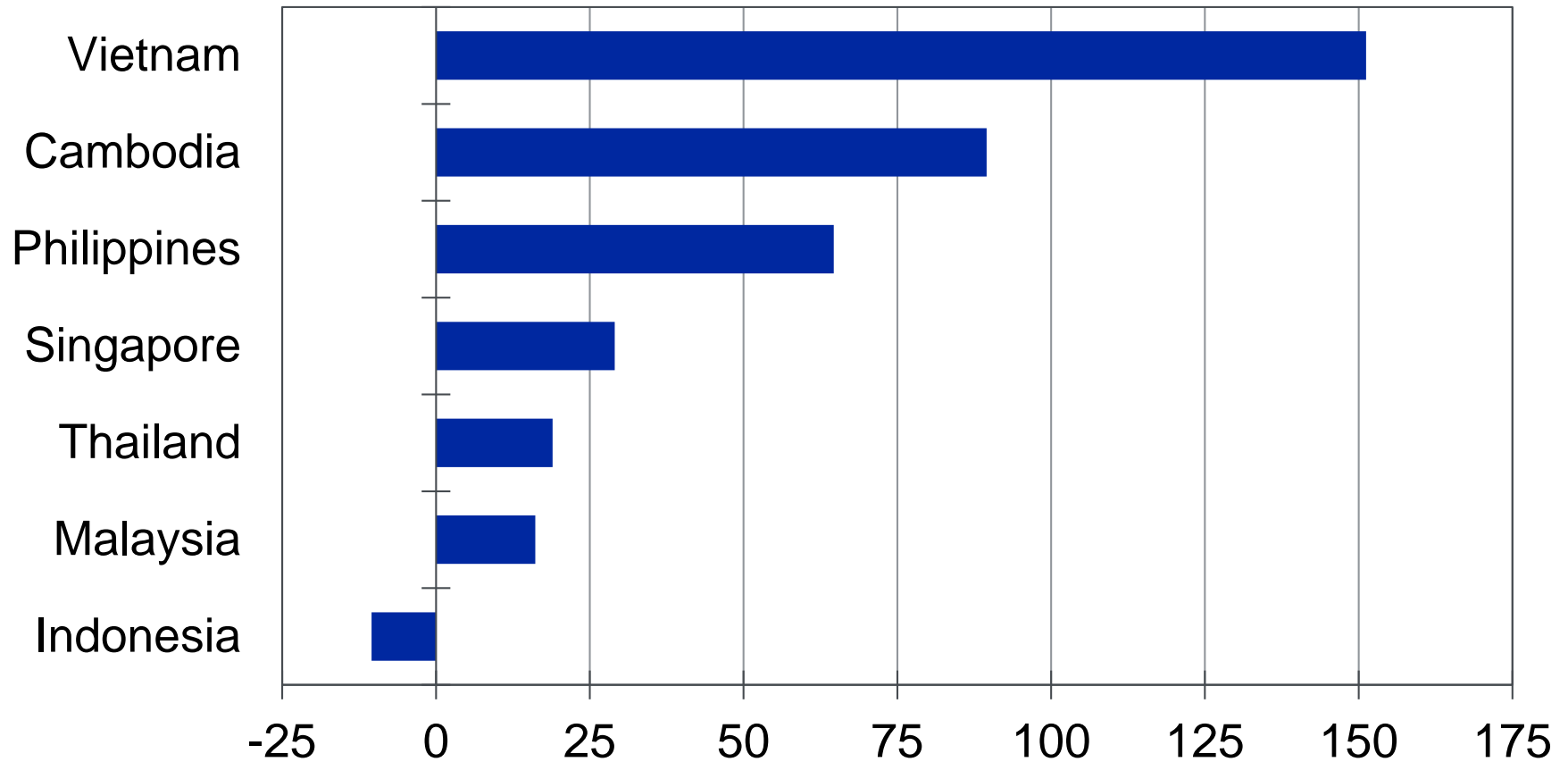
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# Tariffs Hasten Supply-Chain Shift

Import content of Chinese exports, % change, 2010 to 2015



Sources: OECD, Moody's Analytics



# Infrastructure Spending Bearing Fruit

China's fixed asset investment, % change yr ago YTD, 3-mo MA



Sources: National Bureau of Statistics, Moody's Analytics