Reflections

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Trump's trade war: regrettable but manageable in terms of growth

Global import tariffs have trended downward for the past 30 years. But increased populism is fuelling protectionism. The trade war will intensify this autumn. Today the United States and the rest of the world are choosing different trade policy strategies. The effect on global economic growth remains manageable, even assuming new tariffs – with the US as the biggest loser – but will worsen if risk appetite hurts asset prices, for example. Central banks may face the dilemma of managing both higher inflation and downside risks to growth and asset prices.

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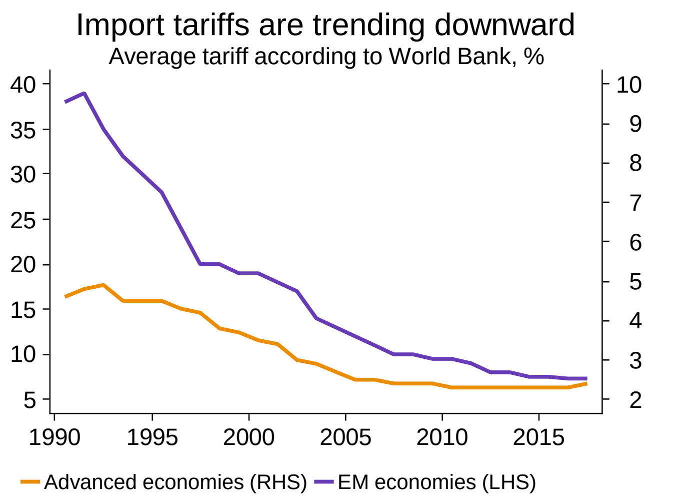
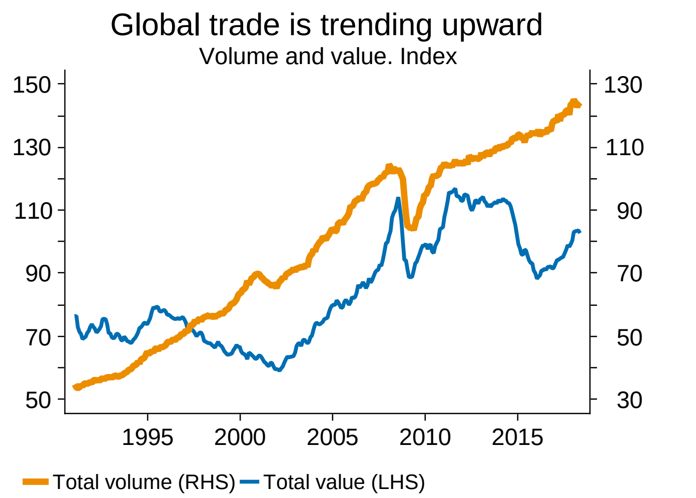
President Donald Trump has boosted import tariffs in 2018, citing "national security" reasons, thus **drawing the US into a trade war with the rest of the world: mainly China, the EU, Canada, Mexico and Japan**. Affected countries have responded to this aggressive new US trade policy by boosting **tariffs on US goods** (see box, page 2) and trying to **expand and intensify**, not worsen, **international trade cooperation**. The 2018 trade war is thus bilateral, not multilateral as in the 1930s.



So far, the world has prioritised lowering tariffs…

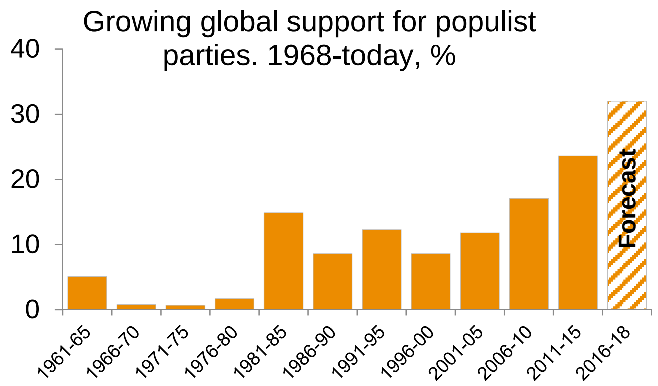
In the past 30 years, most economies have perceived greater advantages than disadvantages in lowering tariffs and thereby stimulating world trade, despite facing the worst economic crisis since the 1930s in 2008-09. According to World Bank statistics (see above), **tariffs in emerging markets averaged 40 per cent in the early 1990s; they average 5 per cent today. In advanced economies, tariffs have fallen from 5 to just over 2 per cent**. Global trade has thus boosted economic growth, living standards and incomes for many people in developing countries. It has also helped squeeze prices, allowed low interest rates and raised real incomes in many advanced economies.

Yet tariffs are **not the only tool** countries can use to gain trade advantages. For example, they can let their **currency** depreciate or impose trade-related **administrative procedures** that are unnecessarily slow and complex. There are many indications that China, despite its denials, has allowed its currency to fall by 8.5 per cent against the US dollar in recent months to stress its displeasure with US trade policy and make it easier for Chinese exporters to cope with tariffs that make them less competitive.



Populism and protectionism are flourishing

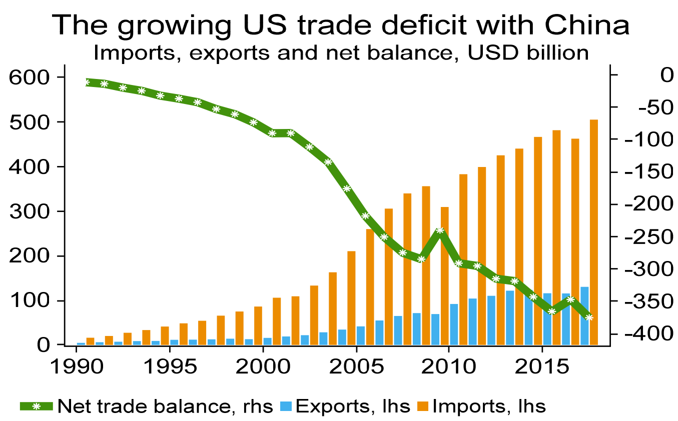
EU and US elections and referendums in recent years indicate that **anti-establishment forces are enjoying tailwinds**. This means that populism is growing (see chart below), which will drive future protectionism and isolationism. Increased **economic inequality**, especially within countries, and migration flows will increase tensions further. Meanwhile we are on the verge of major technological changes (sometimes called the **4th industrial revolution**), which are creating great opportunities but also political tensions as labour markets, social welfare and educational systems must adapt themselves to a new world.



Is there any logic to Trump's trade war?

History shows that the **erecting trade barriers has been a losing strategy for the US**. For example, when George W. Bush imposed steel tariffs in 2002, they hurt growth and jobs and were abolished within 21 months. Yet Trump seems to have several incentives to continue his trade war for another while:

1. To keep election promises. Trump won election on promises to bring back US industrial jobs by re-negotiating such pacts as the North American Free Trade Agreement (NAFTA) and imposing tariffs on goods made in China and Mexico. With mid-term elections due November 6, the president must deliver.
2. To decrease import leakage. Because Trump cut taxes by about USD 1.7 trillion over a two year period, imports will increase. But tariffs will make imports more expensive, and demand can be redirected towards American-made goods.
3. To slow the growth of external debt. After many years of large trade deficits, net US debt to other countries is USD 7.9 trillion (41 per cent of GDP). Such large debts make the US vulnerable, even though it enjoys reserve currency status.
4. To shake up the system. By threatening tariffs, the US forces countries to the negotiating table, enabling barriers to be made visible and be resolved in ways that will lead to increased trade.



Source: International Monetary Fund (IMF), Macrobond, SEB

Trade war affects growth, inflation and share prices

A trade war including import tariff hikes affects the real economy via two main channels – directly and indirectly.

• **Directly**: Decreased trade, disruptions in global supply chains and higher costs for imported goods (i.e. inflation);
• **Indirectly**: Uncertainty lowers willingness to invest and consume and adversely impacts asset prices, such as shares.

Both the IMF and the Bank of England (BoE) have estimated[1] the effects of tariffs on growth and inflation. They make somewhat different assumptions about how future tariffs may be adjusted.

The IMF includes both **adopted** tariffs and others **announced** by July 16, including new US-Chinese tariffs and car tariffs). It also adds an indirect effect (**confidence shock**). This worst-case scenario would lower global GDP by about 1.3 per cent through 2021. The **US figure would be about -2.0 per cent**.

The BoE assumes that the US will **triple import tariffs on all** trade partners, i.e. raise them by 10 percentage points. The estimated direct effect would be a **1.2 per cent lower global GDP through 2021**. The **effect on the US would be -2.5 per cent**. Adding indirect effects would double the adverse impact. The BoE also concludes that the world and the US would see accumulated price hikes of 1.1 and 0.8 per cent, respectively, by 2021. This illustrates the policy dilemma for central banks.

Trade war: US, China & the EU – various stages

The trade war has escalated gradually (see below). Note that the BoE's estimates indicate that China's trade barriers against the US are far bigger than equivalent US and EU barriers. Measures now on their way would also increase this gap further.

Average bilateral import tariffs. Per cent

Tariffs imposed by **...on imports from**	**US** **China**	**China** **US**	**US** **EU**	**EU** **US**
Current	2.6	9.1	3.3	3.0
Announced (July 5) incl Trump's car tariffs	4.5	14.9	6.2	7.2

Jan: US imposes tariffs on solar panels, washing machines
Apr 2: China imposes tariffs on US goods (USD 3 bn)
Jun 1: US imposes tariffs on steel and aluminium
Jun 25: EU imposes tariffs on US goods (USD 3 bn)
Jul 6: US/China impose tariffs on each other (USD 34 bn)
Jul 10: US may impose tariffs on China (USD 200 bn)
Jul 25: US and EU agree to continue negotiating
Aug 3: China may impose tariffs on US goods (USD 60 bn)
Aug 8: China announces tariffs on US goods (USD 16 bn)
Aug 23: US imposes tariffs on Chinese goods (USD 16 bn)

Regrettable but manageable in terms of growth

The new US trade policy unavoidably entails downside risks, for example to economic growth, but we believe that the IMF and BoE tend to exaggerate these effects if various other moderating factors are also taken into account:

1. The tariffs adopted so far will have **little impact on global growth** unless the world is suddenly hit by major risk aversion. This is also true if tariffs rise further (as assumed by the IMF).
2. The trade war is still bilateral (between the US and the rest of the world) – **not multilateral**. The EU and Japan have now put a free trade agreement in place that covers one third of the world economy, confirming the widespread desire for more free trade.
3. The **US** is the country whose growth will be hardest hit, which should influence American public opinion.
4. Tariffs help **redirect trade flows**, which will also **benefit growth in various countries**, but **high resource utilisation** in many countries could make it harder to shift global production.
5. Economy policy may again be shifted in a more **expansionary direction** to support growth, for example in China.

Our overall conclusion from the above estimates and arguments is that absent a surge in risk aversion, **global growth will remain resilient** to disruptions even if the trade war escalates further.

[1] *"G-20 Surveillance Note"*, IMF, July 18, 2018, and *"From Protectionism to Prosperity"*, Mark Carney, Bank of England, July 5, 2018.