BBVA Research

Global Economy

Closer to a trade war?

Expansión (Spain)

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Friday, May 10, was the day the United States raised tariffs again on USD 200 billion of imported Chinese goods, slightly over a third of the total, taking the tariff from 10% to 25%. The measure is part of a strategy to apply pressure at a moment when it looked as though the US and China were on the brink of closing a deal that would increase the purchases of US goods, reduce subsidies on Chinese exports and strengthen the presence of American companies in the Asian country's domestic market. All of the foregoing, and above all, that would protect intellectual property in business more effectively, eliminating forced technology transfers. The US believes that China is reneging on matters that had already been agreed on in the negotiation. Meanwhile, despite the retaliatory measures announced by China and the notice by the United States to limit the activities of Chinese companies that are considered a threat to national security, it seems that the conversations have not broken down, that the encounters will continue and that a key date might be the meeting of the leaders of China and the USA at the next G20 to be held in Japan in June.

Nothing new in as much as the United States is going the wrong way about achieving one of its goals (cutting its bilateral trade deficit with China) and using the wrong weapons − tariff increases − which, as well as being useless as the US deficit will go up until it saves more or invests less, are counterproductive. Indiscriminate tariffs are a risky strategy, destroying trust and weakening global value chains that increase the availability of products at more attractive prices. This is not to say that China's trade policy, in which the free market plays a limited role, should not be confronted to ensure the existence of a more balanced global framework for all. There are many demands that need to be made of China, some of which the US has highlighted, but this must be done without endangering all the progress that has been made, by building partnerships in multilateral forums such as the World Trade Organization, which needs to be beefed up to make it more decisive and effective.

The global economy is one step closer to total trade war if, after the announced rise and Chinese retaliation, the US carries through its threat to slap tariffs on China's remaining imports. The positioning of the financial markets, with falls in equities, flows to safe-haven assets and increased volatility, will have real effects on activity because of higher financing costs and lower confidence. Effects which will compound those emanating directly from the increased tariffs, a rise in prices that brings down demand for goods because of the lower real purchasing power of households and companies.

It is very difficult to make a quantitative estimate of the impact of these measures. First, there is no recent evidence from similar measures. International trade costs, and in particular tariffs on goods, have been steadily and continuously falling, putting them at minimums not seen for several generations. Furthermore, the econometric models available do not allow us to be precise about the impact of a very complex phenomenon, that involves a host of geographies, products and types of trade-flow barriers, without establishing strong hypotheses along multiple fronts (the elasticity-price of exports and imports for each economy, for example, or its capacity to replace imports quickly with domestic production).

At BBVA Research we estimate that a tariff increase to 25% could bring Chinese GDP down 0.5 pp from our base scenario, in which China grows by around 6% in 2019. The impact on the other two trading blocks will be less severe, around 0.2 pp in the United States and 0.1 pp in the eurozone. If the matter goes further, which we cannot rule out at this juncture, but which is a tail risk, with tariffs on all imports from China and retaliatory measures, the impacts could more or less double, with uncertainty biased towards more intense effects due to the combination of real and financial channels in a vulnerable global scenario, and given that economic demand policies have little room for manoeuvre, much less on a coordinated basis. The global economic panorama would then be one of sharp correction, the most intense since the financial crisis of 2008-09.

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