CHINA / US TRADE DEAL

ANDREW LAKE, HEAD OF FIXED INCOME AT MIRABAUD ASSET MANAGEMENT GIVES HIS VIEW ON THE LATEST NEWS IN THE US / CHINA TRADE DEAL AGREEMENT

PHASE ONE SIGNED!

May 2019 seems almost a lifetime ago, but barely seven months from when the US/China trade deal was suddenly off the table, with all of the ensuing uncertainty for businesses, global supply chains, and world economic growth as a result, we have “a deal”.

The unexpected news in the latter part of 2019 that a deal was back on the table precipitated a very strong year end rally across financial markets. The deal was finally signed on the 15 January. Is it the panacea that the markets have been pricing in? Will there be a Phase Two this close to the US Presidential Election? Does Phase One do anything more than indicate a truce given the increasing economic damage this trade tussle was having on not just the US and China, but world economic growth as well?

Whilst we have yet to see if there are any differences between the English and Chinese versions of the Agreement, the basic tenets are:

- China will commit to do more to deal with the theft of US intellectual property and technology.
- China will spend $200bn on US goods (primarily farm products) to close the trade imbalance gap.
- China will avoid currency manipulation.
- The US will maintain tariffs on two thirds of Chinese imports to ensure compliance.

WHAT IS NOT MENTIONED?

- Computer hacking of US companies and state entities.
- Subsidies for Chinese companies that support China’s aim to be the pre-eminent global economic power over the next several decades.

The market reaction was fairly muted as the deal was mostly priced in. The fact that tariffs remain in place until Phase Two is negotiated just prolongs uncertainty. The Agreement can still break down over the ensuing months, and we do not have any clear indication of how quickly Phase Two will be dealt with. If there is a delay until post the election, and President Trump is re-elected, then there is the real risk that the US position becomes far more hawkish given the President will then be free from the shackles of having to be re-elected.

In addition, whilst there is a 90 day enforcement period to correct any breaches of the Agreement, most of this compliance really depends upon whether China will execute the Agreement or not. Most of the IP commitments have been dealt with by China before the deal was signed, so there is not really any new commitments in the Agreement. Interestingly, the changes in the Chinese legal system that was one of the reasons the negotiations broke down in May, were not included in the deal.

Market attention will now turn to the Chinese version to see if there are any discrepancies versus the English one. Enforcement, and a timeline to Phase Two will be needed for the risk of a re-escalation to diminish substantially from here. The fact that both sides wanted a truce would seem to indicate that at least in the short term, the status quo will be resumed, and that is what the financial markets are pricing in.

AS OF 16.01.2019

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