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Although a Phase One agreement has been reached, there is still the risk US-China tension may worsen

JIROU SUGIE
ECONOMIC RESEARCH OFFICE

MUFG Bank, Ltd.
A member of MUFG, a global financial group

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On 13th December 2019, the US and Chinese governments both announced that they had reached an agreement on a Phase One trade deal which covers seven chapters, such as intellectual property, technology transfers and an expansion of trade (Table 1). Upon reaching this agreement, the US shelved the USD 160 billions' worth of tariffs it was planning to impose on Chinese imports on 15th December. In addition, the US is scheduled to lower its additional tariffs on the USD 110 billion of Chinese imports it imposed in September 2019 in the 30 days following the formal signing of the agreement (15% to 7.5%). US Trade Representative Lighthizer said they were "aiming for the first week of January" for the formal signing.

There is no doubt that this agreement is a positive development considering the downward pressure which the US-China trade friction has put on the global economy. However, it would be too hasty to say the underlying conflict between the two countries has been resolved; there was some difference between the press releases announced by the US and China, and the hurdle to implementing the agreement is high. In the statement released by the USTR, China will import US goods and services in a total amount that exceeds its imports of those goods and services in 2017 by "no less than USD 200 billion over the next two years". Assuming the target increase in trade will be divided equally between 2020 and 2021, China must import USD 286.3 billions' worth of goods and services from the US (imports in 2017 = USD 186.3 billion, plus a target USD 100 billion per year). This is roughly a 70% increase from the USD 168.8 billion of US goods and services imported by China in 2019 (current figure annualised), and is an extremely high level to achieve (Table 1). Both countries introduced a framework to ensure implementation of the trade agreement, so if China cannot reach this target, there is a possibility the US will cite China's failure to comply with the agreement and will restore its tariffs, to which China will retaliate with its own measures, resulting in a repetition of the rise in US-China friction which has occurred on multiple occasions in 2019.

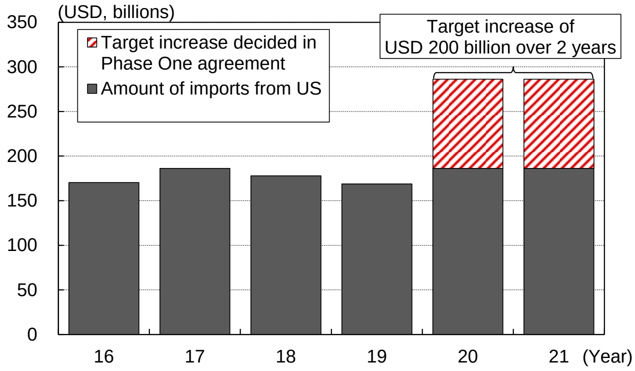
The Phase One agreement does not include a revision to China's industrial subsidies, which have been a point of serious contention between the two countries and have been criticised by the US, who says they lead to an increase in the trade deficit and a loss of employment. It appears this point will be up for discussion in the negotiations for Phase Two, but reaching an agreement on this point will be even harder than it was for Phase One and the negotiations will inevitably be difficult. While there is a currently a lull in the conflict between the US and China, there is ample risk that it will reignite and it is important to remain cautious.

Table 1: Outline of the US-China Phase One Trade Agreement

US' Announcement		China's Announcement
Chapter	Outline	Outline
1. Intellectual property	Addresses concerns related to trade secrets, pharmaceutical-related intellectual property, pirated and counterfeit goods	Agreed on same 7 chapters (did not annouce details of numerical target for trade expansion): ① Intellectual property ② Technology transers ③ Food and agricultural products ④ Financial services ⑤ Exchange rate and transparency ⑥ Expanding trade ⑦ Bilateral assessment and dispute settlement
2. Technology transfers	Address China's unfair technology transfer practices	
3. Agriculture	Remove structural barriers to trade, support a dramatic expansion of US agricultural product exports	
4. Financial services	Remove investment barriers for US financial service providers	
5. Currency	Commit to transparent currency policy, correct unfair currency practices	
6. Expanding trade	Commitment by China to import US goods and services over the next 2 years in a total amount that exceeds China's imports in 2017 by no less than USD 200 billion. Continue to increase imports on this trajectory for several years after 2021	
7. Dispute resolution	Set forth agreement to ensure implementation of this agreement	

Source: USTR, State Council press release, MUFG Bank Economic Research Office

Chart 1: Chinese Imports from the US



Note: 1. Figure for 2019 is annualised calculation of results up until now
2. Figures for 2020 and 2021 show the scenario where the 2-year target increase in exports is shared equally across both years on top of the amount of imports from the US in 2017

Source: Department of Commerce, MUFG Bank Economic Research Office

Translation by Elizabeth Foster

For further details, please contact the Economic Research Office, MUFG Bank

Managing Director, Rei Tsuruta Tel: +81-(0)3-3240-3204

Written by Jirou Sugie <jirou_sugie@mufg.jp>