

# Research China

## Don't rule out a US-China trade war just yet

There have been a couple of interesting developments lately in US-China trade relations.

- **First: Donald Trump has chosen a more conciliatory path with China.** His telephone call with China's president Xi Jinping on 9 February was described by the White House as a 'lengthy' and 'extremely cordial' conversation and Trump agreed to support the One China policy at the request of Xi Jinping. Chinese state media also wrote in a new and more optimistic tone about US-China relations following the call. The change of style by Trump on the China issue is positive with respect to avoiding a conflict between the two nations.
- **Second: however, only four days later *The Wall Street Journal* reported that the US was eyeing a new tactic to press China on the trade issue.** According to the article, the commerce secretary would designate the practice of currency manipulation as an unfair subsidy when employed by *any* country, instead of singling out China. US companies would be able to bring anti-subsidy actions themselves to the US Commerce Department against China or other countries.

Apparently, the new National Trade Council in the White House headed by China hawk Peter Navarro is drawing up the plan. The plan aims to balance the goal of challenging China on trade and currency while keeping relations with the country on an 'even keel'.

Using this tactic, the US would avoid singling out China, as it would also include other nations. However, it might also mean that the US would add a country such as Germany, which the Trump administration has accused of having a much undervalued currency through its membership of the euro.

### Key points

- Trump has struck a softer tone towards China lately.
- However, at the same time his economic team is looking at ways to take measures against China in a less confrontational way.
- Although the softer tone is a positive development, we doubt that Trump has changed his views on China.
- It is thus too early to call off the risk of a US-China trade war later this year.

### Recent research on China

*Flash Comment China: Rise in inflation set to trigger monetary tightening*, 14 February

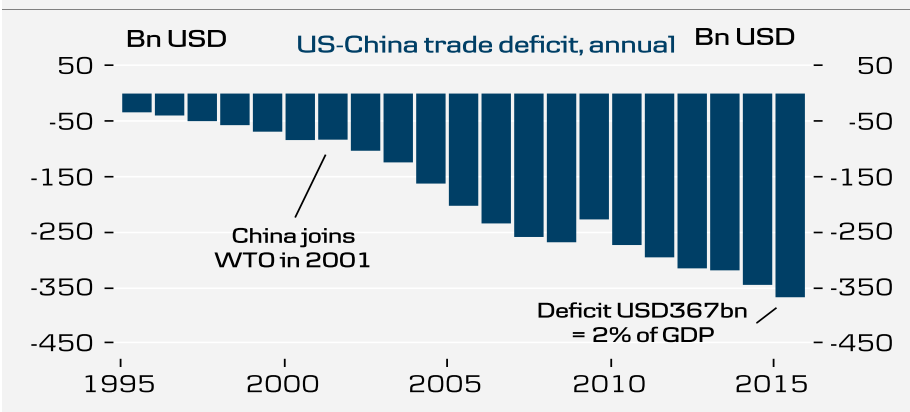
*Strategy: China to weigh on the global cycle in 2017*, 10 February

*Flash Comment: Chinese FX reserves fall to six-year low*, 7 February

*China leading indicators: Signs of a peak in the business cycle*, 6 February

*Strategy: Self-defence or protectionism? Depends on who you ask*, 3 February

### US-China deficit is big – and rising



Source: Macrobond Financial, Bloomberg, Danske Bank Markets (basket own calculation)

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The change of tactic by the Trump administration would also solve another problem: it is very difficult for the US government to label China a ‘currency manipulator’ according to the three criteria stipulated by the US Treasury Department, as China meets only one of the three.

- **Another tack that the US administration is considering taking according to *The Wall Street Journal* is to produce alternative trade deficit numbers**, which would increase the US trade deficit and thus support the case for ‘defensive steps’ on trade. The new method would exclude re-exports when calculating exports in the trade balance statistics. Re-exports are goods that are imported and then re-exported without any value added to the goods. The motivation for the adjustment would be the idea that only exports of goods that are produced on US soil count as real exports.

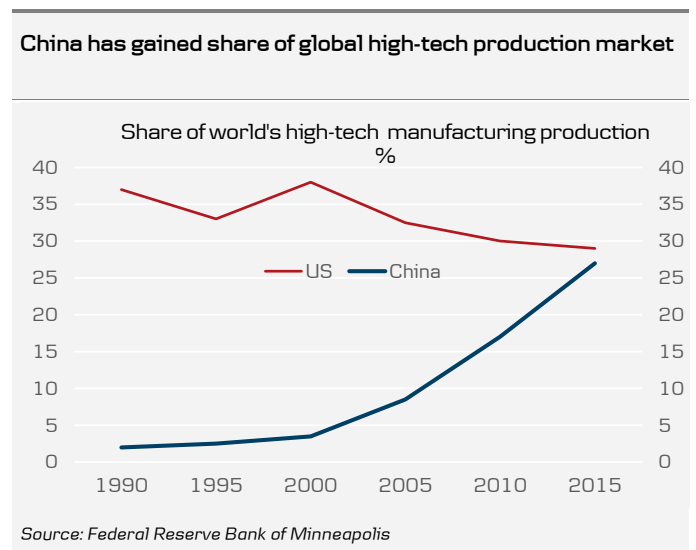
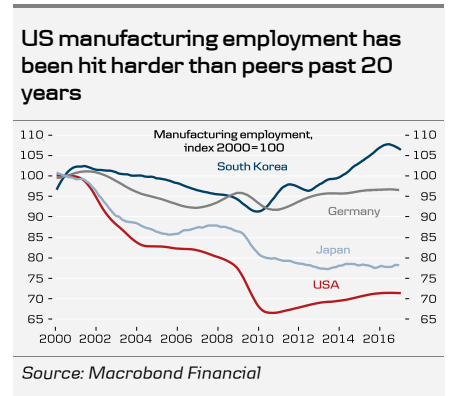
The problem with this method is that it does not also subtract the imports that go into the re-export from the import side of the trade balance. Hence, it would adjust only one side of the deficit (exports) but not the other (imports) and, therefore, it would give a very distorted picture. This picture would overstate the US trade deficit and for Trump underline how much the US is losing from trade. It would affect the deficit with Mexico and Canada in particular, with China less affected.

### Has Trump changed his mind on China?

**What to make of all this? While it is positive that Trump has chosen a more friendly tone with China, it is too early to disregard the risk of a trade war.** We doubt that the Trump administration has changed its view that China has manipulated the currency or used unfair trade practices for many years.

The economic *White Paper* produced during the presidential campaign by Peter Navarro and secretary of commerce Wilbur Ross makes it very clear that China plays a dominant role in why US growth slowed after 2001 – the year of the Chinese accession into the WTO.

In addition, Navarro has used a lot of his research in recent years to show how China is responsible for the weakening of US manufacturing in recent decades, not least in the book ‘Death by China’, which he made into a documentary and which Donald Trump endorsed on the movie’s website with the words: ‘Death by China is right on...I urge you to see it’.



The Trump team sees the manufacturing sector as instrumental for an economy's strength and wants to defend the US against what it sees as 'unfair trade practices' (see also *Strategy: Self-defence or protectionism? Depends on who you ask*, 3 February).

**That Trump has mainly changed tactics but not his views is also indicated by his very clear comments on the Chinese currency just one week prior to the telephone talk with Xi Jinping:** 'Every other country lives on devaluation. You look at what China's doing...They play the money market, they play the devaluation market and we sit there like a bunch of dummies'. In addition, only about a month ago Trump said 'Certainly they are manipulators' when asked about the Chinese currency policy in an interview with *The Wall Street Journal*.

### Trade war still a risk this year

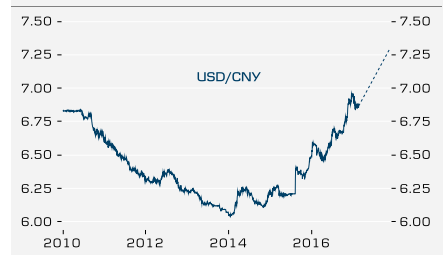
Only time can tell what the next episode of the Trump show will bring. However, **we are not yet convinced that he has suddenly gone soft on China and put his campaign goals of protecting the US against unfair Chinese trade policies back in the drawer.**

It's hard to gauge what the grand plan for Trump is to level the playing field with China. Unpredictability seems to be part of his negotiating style. Suddenly questioning the One China policy on Taiwan after his election may have been part of a strategy to scare China and show what he is capable of if China retaliates in response to US protectionist measures.

Watching the Chinese media's response to his threats, Trump may also have realised that the Chinese will not change any trade practices themselves. His way forward could be to take his own steps to protect US manufacturing from China, while at the same time talking smoothly to the Chinese leadership.

**If Trump takes 'defensive' measures towards China (or other countries), China cannot be expected to sit back and watch without retaliating.** However, if it comes to a trade war, it would enable Trump to paint a picture at home that he has been very open and friendly and merely taken fair measures to level the playing field but that China is the one retaliating in an aggressive way.

**Weaker CNY vs USD a red flag for Trump**



Source: Macrobond Financial

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