

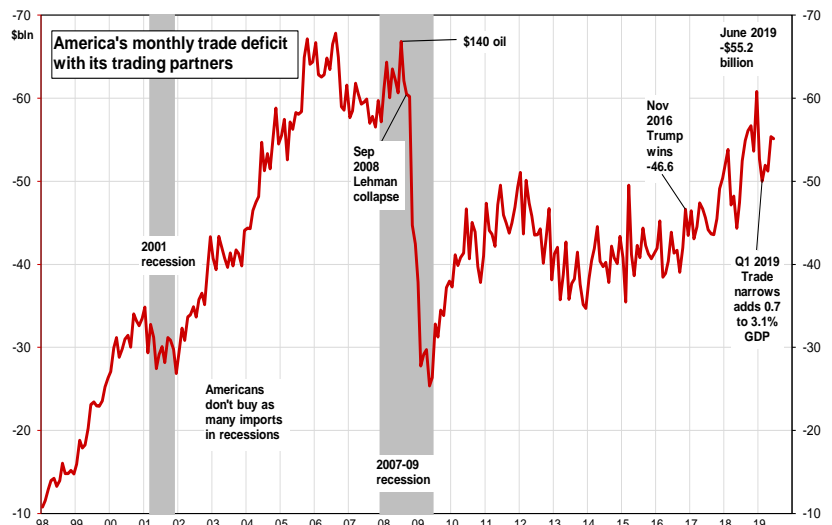
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## TRADE WAR? WHAT TRADE WAR?

Talks to resolve America's big trade war with China have stalled; China is the country where the trade deficit in goods is the largest at \$419.5 billion in 2018 with \$120.1 billion in goods we export to them and the lopsided \$539.6 billion in goods America imports from China. The president doesn't care, and the markets don't care either. The stock market is the best proxy of what the public thinks about the trade war. Stocks plummeted nearly 1,000 points on Monday, August 5 when China's currency weakened, pushed or fell, through the 7.00 line, and the US scrambled to label China a currency manipulator. But Dow industrials rallied back by Friday ending with a 197-point loss of 0.7% for the week. Stocks rallied back even after being hit with more selling Friday morning when Trump told reporters "We'll see whether or not we keep our meeting [with China] in September. If we do, that's fine, if we don't, that's fine." The latest escalation of 10% tariffs on the rest of the goods imports from China are expected to take effect on September 1. Stocks and the president don't care.



Trade War 2018			
Trade deficit in goods			
\$ billions		Exports	Imports
China	419.5	120.1	539.6
EU	168.6	318.3	487.0
Germany	68.0	57.7	125.8
Mexico	80.6	265.4	346.1
Japan	67.1	75.2	142.4
Vietnam	39.4	9.6	49.1
South Korea	17.7	56.5	74.2
Canada	19.0	299.7	318.8
World	874.8	1,665.9	2,540.8

We care. That's why we are writing about trade this week. Time will tell if Trump's act of raising tariffs on the final \$300 billion-odd China imports to the 10% first-stage retaliation level will bring the world to the brink of recession. The US bond market seems to think (hope?) so with 10-yr yields closing at 1.75% this week, which more or less discounts two more 25 bps Federal Reserve rate cuts to 1.75%.

Not a lot has changed since 2014 on the US exports to China side. Trying to develop export markets can take decades, and this was an issue in the trade war with Japan in the late 80s, where tariffs and free trade aside, it is not easy to “find something to sell them.” We sold \$13.9 billion of civilian aircraft in 2014 and that moved up to \$18.2 billion in 2018. But passenger cars have fallen from \$11.2 billion in 2014 to \$6.6 billion in 2018. Crude oil has moved up from zero in 2014 to \$5.4 billion last year. But soybeans have plummeted from \$14.5 billion in 2014 to \$3.1 billion in 2018.

Trade with China has slowed further this year at the halfway mark. Exports of goods to China from January to June 2019 are \$52.0 billion, down 18.9% from \$64.1 billion in the first half of 2018. Imports of goods from China so far this year are \$219.0 billion, down 12.4% from \$250.0 billion in the first half of 2018. If this trend continues into the second half of the year, 18%

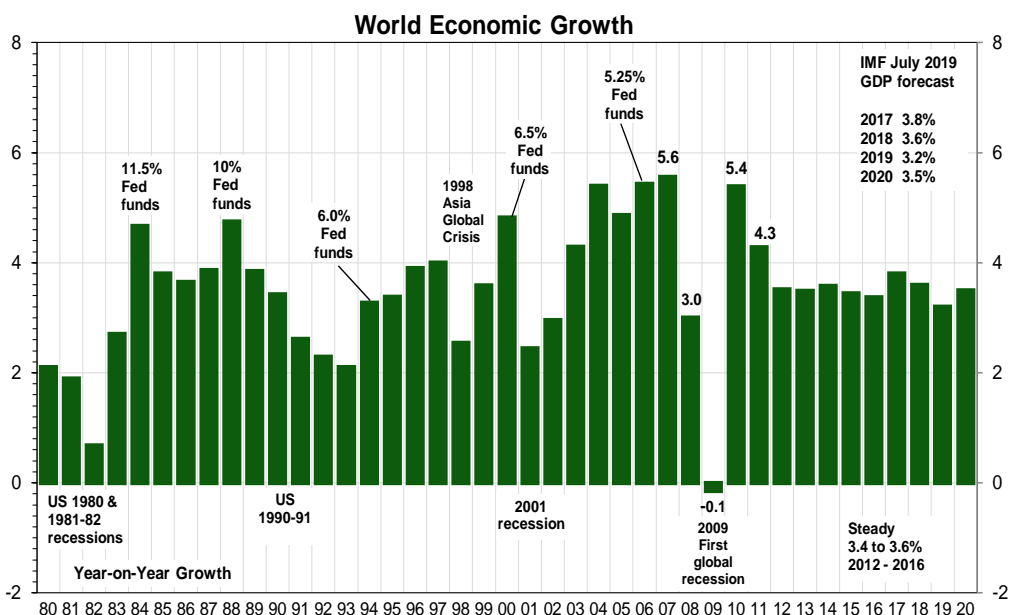
### U.S. Exports of goods to China

Billions of dollars	2018	2017	2016	2015	2014
Civilian aircraft, engines, equip, parts	18.221	16.264	14.577	15.440	13.927
Semiconductors	7.117	6.077	5.956	5.976	5.511
Industrial machines, other	6.822	5.448	4.875	4.483	4.439
Passenger cars, new and used	6.638	10.208	8.843	9.056	11.178
Crude oil	5.431	4.379	0.361	0.015	0.021
Plastic materials	3.981	4.004	3.525	3.559	3.858
Medicinal equipment	3.727	3.453	3.231	2.887	2.568
Chemicals-other	3.197	2.982	2.468	2.415	2.642
Soybeans	3.129	12.231	14.212	10.494	14.485
Measuring, testing, control instruments	3.128	2.765	2.649	2.639	2.497
Pharmaceutical preparations	3.024	2.681	2.166	2.005	1.750
Pulpwood and woodpulp	2.920	3.359	3.368	3.425	3.368
Other parts and accessories of vehicles	2.864	2.720	2.332	1.868	2.100
Logs and lumber	2.835	3.177	2.503	2.007	2.605
Chemicals-organic	2.470	2.294	2.144	2.239	2.208
sub-total	75.503	82.044	73.210	68.507	73.157
Total	120.148	129.797	115.594	115.873	123.657

drop in exports and 12% decline in imports, then the goods deficit will narrow from \$419.5 billion in 2018 to \$376.4 billion in 2019. The trade deficit in goods with China was \$346.8 billion in 2016 before Trump took office showing trade wars are not proving easy to win. Back to square one.

As far as the world economic outlook, the worries continue to rise that the slowdown in trade will curb economic growth. The IMF issued its world economic outlook update forecast on July 23 and growth was expected to slow to

3.2% in 2019, a tenth lower from its 3.3% forecast on April 9. The slowdown in growth is still much more modest than the market’s fear of global recession. The only year that the world economy actually turned down was in 2009 after the worldwide financial crisis sparked by the Lehman bankruptcy in September 2008. Growth in China is expected to slow to 6.2% this year and 6.0% in 2020. It had been 6.8% in 2017 and 6.6% in 2018.



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