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.

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% 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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