



# AGF Insights and Market Perspectives

## Global trade tensions are on the rise. What's next?

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After months of optimism, trade tensions have reached a new intensity, with U.S. President Trump launching further trade actions, most notably against China, Mexico and India. In fact, no country appears immune to the tariffs and bans, marking a pivotal shift in U.S. policy.

These recent moves not only highlight the increasing weaponization of trade by the U.S. government, but raise the spectre of increasing headwinds to sentiment, global trade, economic growth and financial markets—if not a global recession.

However, we still believe that while ideological tensions are likely to persist between the U.S. and China, a trade agreement can be reached. However, with so much at stake, China will not capitulate to just any deal. It will truly have to be one which meets the needs of both countries.

### U.S.-China tensions turn from trade to technology war

The tone in China turned increasingly negative following President Trump's executive order last month banning U.S. companies from using information and communications technology from organizations considered to be a national security threat. Immediately, the U.S. Department of Commerce added Huawei Technologies Co. Ltd. To its 'Entity List', effectively barring it from buying the components from U.S. companies without U.S. government approval—an act China saw as a direct form of aggression towards their 'national champion' tech company and dominant player in 5G technology.[\[1\]](#)

In our view, this sharp pivot to turn tensions from a trade war into a technology war is based on a vast overestimation of China's technological capabilities. Indeed, while China is quickly moving up the value chain, it still undergoing a significant change as it moves from an emerging market to a developed economy.

Meanwhile, in response to the U.S. government's actions, China retaliated by creating the 'Unreliable Entity List,' a directory which will include foreign companies, individuals and organizations that break commercial contracts and stop supplying Chinese firms. However, so far, China's overall response has been measured. In a new white paper formally outlining its position, China stressed the importance of cooperation between the two nations as the only path towards a better future. [2]

### **Up next? President Trump targets Mexico and India**

Just as the White House was making headway with its push to ratify the United States-Mexico-Canada Agreement (USMCA), President Trump announced he would impose a 5% tariff on all imported goods from Mexico and would continue to increase tariffs each month until they reach 25% if the border crisis persists, effective June 10<sup>th</sup>.

However, three days shy of the deadline, the President announced the two countries had reached an agreement and that the tariffs would thereby be "indefinitely suspended." As part of the deal, Mexico has pledged to deploy its National Guard throughout Mexico while prioritizing its southern border with Guatemala. Mexico also agreed to expand its program to allow asylum-seekers to remain in Mexico while their legal cases are underway. Still, while the deal offers few new solutions to stem the flow of migrants, and some suggest that Mexico had already agreed to such border actions months before Trump's tariff threat, it was enough for Trump to claim a political win.

Meanwhile, President Trump weaponized trade once again by terminating India's designation as a developing nation. This ended years of preferential treatment allowing the country to export approximately 2,000 products into the U.S. duty-free, including auto components and textile materials. Still, we believe the impact on India's economy is fairly immaterial given that exporters were deriving duty-free benefits on US\$190 million of the total US\$5.6 billion worth of items traded.[3]

### **What's next?**

While we continue to believe that a trade agreement can be reached between the U.S. and China, the ongoing ideological tensions between the two countries will likely continue to persist if history is any indication. If there is one thing we have grown accustomed to under President Trump's presidency, it is the unpredictability and velocity with which things can change. Last year, a similar ban to Huawei on the Chinese telecom equipment maker ZTE Corp. was resolved sooner than later. However, any deal China would accept would have to be based on mutual respect and cooperation. And China has made it clear that it will not compromise on major principles.

In the meantime, China will likely continue to stimulate its economy, just as it did following the U.S. tariff increase by cutting the reserve requirement for small and medium-sized banks.

Still, rising trade uncertainty points to increased global economic and market risks. Should President Trump continue to push his trade agenda forward by imposing further tariffs—the global economy could be pushed into recession. Of course, a trade settlement could prevent such a negative outcome.

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[\[1\]](#) Dell'Oro Group, April 3, 2019.

[\[2\]](#) China's State Council Information Office: China's Position on the Economic and Trade Consultations, June 2, 2019.

[\[3\]](#) Deutsche Bank, June 6, 2019

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