

PROTECTIONISM

May 2018

Photo by Clay Banks on Unsplash



TRADE GAMES, TRADE FEUD OR TRADE WAR?

- 04 President Trump's Protectionism: Fake News or Old News?
- 07 Why Trade Games Only?
- 09 How Disruptive Could a US-China Trade Feud or a Trade War Be?
- 10 Financial Protectionism Should be Monitored Closely

EXECUTIVE SUMMARY



Ana Boata, Senior Economist for Europe
+33 184 114873
Ana.BOATA@eulerhermes.com



Mahamoud Islam, Senior Economist for Asia
+852 3665 8989
Mahamoud.ISLAM@eulerhermes.com



Alexis Garatti, Head of Macro and Thematic Research
+33(0)1.84.11.33.83
Alexis.Garatti@eulerhermes.com



Ludovic Subran, Global Head of Macroeconomic Research at Allianz and Chief economist at Euler Hermes
+33 184 115399
Ludovic.SUBRAN@eulerhermes.com

- Last March, Donald Trump decided to drag age-old protectionism out of the past, imposing tariffs on US imports. Retaliation from China – the main target – followed; a solution may be on its way, yet, fears of a trade war resurfaced. A closer look point to mere trade skirmishes. Electronic, Electric, Machinery and Equipment and Automotive are the most at-risk industries according to our protectionism tracker.
- Beyond the fact that initial threats were generally followed by negotiations and exemptions, the magnitude of the exports at risk, and the risks to derail the economic upswing sound like good reasons to take markets anxiety with a pinch of salt. When taken together, all measures would result in +0.5pp increase in China and US total import tariffs. This Trade Games scenario (highest likelihood) represents USD30bn per year of combined export losses for the US and China i.e. less than 0.1% of global trade of goods and services. For the US, expected impacts on growth, inflation, trade are negligible (+/-0.1 pp max) as well as on business insolvencies (less than +1 pp) but twin deficits could increase by -0.6 (trade) and -1.1 pp (fiscal).
- Alternative scenarios include a Trade Feud (trigger: +2.5pp in world import tariffs or a 15% tariff for all US imports from China) and a Trade War (+8.5pp of world import tariffs or a 45% tariff on all US imports from China). Both would be (very) disruptive for markets, global trade, business insolvencies, and growth in the US, the EU and China.
- While less tweeted about, other forms of protectionism (Financial, Regulatory, Data, Currency, Environmental, Sanitary, Security, Intellectual Property) could be even more disruptive. On the financial risks, capital controls and currency manipulation should be monitored should tensions escalate between the US and China.



Photo by Clay Banks on Unsplash

US and China combined estimated export losses if all increased import tariffs are implemented

USD 30 bn

TRUMP'S PROTECTIONISM

FAKE NEWS OR OLD NEWS?

Since the beginning of the year, President Trump has demonstrated a certainchutzpah for protectionism announcements and measures (see Figure 1).

Truth be told, many countries have been exempted since such announcements - from the steel and aluminum tariffs e.g. -, and the second wave of announcements, tar-

geted at China, could end up being negotiated directly between the US and China.

Much ado about nothing?

Figure 1 Protectionism timeline

| Date | Measure |
|------------------|---|
| March 8, 2018 | The US government announces a 25% tariff increase on steel and a 10% tariff on aluminum, later exempting Europe, Australia, South Korea, Brazil and Argentina (Canada and Mexico were exempted from the start) |
| March 8, 2018 | The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (TPP without the US) was signed and could enter into force this year. |
| March 22, 2018 | The US government announces a 25% tariff increase on additional products to a total of USD 60bn of imports from China |
| March 22, 2018 | Leaders of 44 African countries agrees deal for Continental Free Trade Area (CFTA) |
| March 23, 2018 | The Chinese government announces measures of retaliation with a 15% to 25% tariff increase on USD3bn of Chinese imports from the US |
| March 29, 2018 | The US president Donald Trump recently threatened to revise or block a new trade pact with South Korea in order to incite Seoul contributing more to geostrategic issues implicating North Korea. The US President has also coordinated security issues and trade agreement with Australia. In this new context embodied by an interconnection between trade and security issues, the US President is revisiting the majority of its trade relation (NATO and Euro zone trade surplus are now an implicit background of all ongoing discussions between the US and main European trade partners). |
| April 4, 2018 | The Chinese government announces further retaliation with a 25% tariff increase to a total of USD50bn worth of imports from the US |
| April 8-11, 2018 | President Xi Jinping restated its plan to open China further in the Boao forum with: (i) further opening for the financial (removal of foreign ownership limits on banks, e.g.) and the manufacturing sector (relaxed rules for foreign investors); (ii) lower import tariffs for consumer related products especially vehicles; (iii) further legal protection of intellectual property; (iv) use the Belt and Road project as a new driver for multilateralism. |
| April 24, 2018 | President Trump said that he is confident that both the US and China could reach a deal on both trade and intellectual property |
| May 22, 2018 | US decision whether to impose the import tariffs or not and date for implementation (June/July) |



Photo by Clay Banks on Unsplash

In the meantime, global trade is actually doing well. Global trade volumes rose by an estimated +4.8% in 2017 while protectionist measures continued to pile up (+489 new measures in 2017 compared to 2016 (see Figure 2). The acceleration of global growth was strong enough to more than offset the dampening effects of these new protectionist measures and push many countries to open up again to benefit from the synchronized acceleration in growth. Interestingly, the US was already the most active country in developing new protectionist measures (+90 measures in 2017 from +84 in 2016). Among large economies, it is the only one with an increased number of new measures.

The US has always been a free trade promoter, initiating both the WTO (World Trade Organization) in 1995, and the GATT in 1948 (General Agreement on Tariffs and Trade,

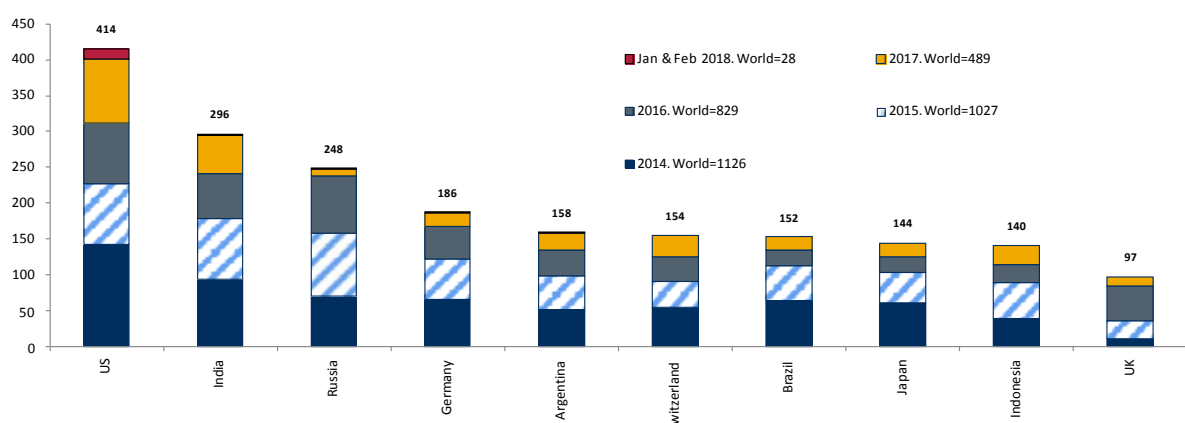
WTO's predecessor) to avoid the devastating impact of protectionist initiatives such as the US Smoot-Hawley tariffs. Yet, trade liberalization never was a walk in the park: WTO disputes, the rise of non-tariff measures, and periods of protectionist rhetoric are common in the context of elections. Previous American Presidents did not hesitate to have recourse to protectionist measures for electoral purposes. The upcoming mid-term elections in November 2018 certainly explain the hostile rhetoric. Indeed, opposing free trade to the well-being of American families is not new in a late economic cycle, marked with volatility and nervousness, rising twin deficits, and the implementation of a fiscal stimulus.

The ongoing aggravation of twin deficits in the US (the current account deficit reached 2.3% of GDP in 2017 and the fiscal deficit amounted

3.4% of GDP in 2017, the highest cumulated twin deficit since 2013) explains the higher aggressiveness in terms of trade policy of the US Government.

The use of tariffs though, is from another time. As a result, the average tariff rate of the US has registered a structural decline to reach today 3.5% of duties on all imported products. Indeed, tariffs represent old instruments of trade policy, which were progressively sidelined to the profit of more imaginative or disguised forms of protectionism (technological content, anti-dumping measures, sanitary regulation, and technical constraints). However, they have the advantage to be rapidly advocated and applied in circumstances that the US President judged as representing a threat for national security, without the approval of the Congress traditionally required for trade issues.

Figure 2 New protectionist measures by top 10 countries



Sources: GTA, EulerHermes

Figure AUS trade deficit by country and by sector for top 20 import markets, USDbn (*)

| | Total | Energy | Agri-food | Textile | Wood paper | Chemicals | Iron Steel | Non-Ferrous | Machinery and equipment | Automotive | Electrical equipment | Electronic equipment | Miscellaneous |
|-------------|--------|--------|-----------|---------|------------|-----------|------------|-------------|-------------------------|------------|----------------------|----------------------|---------------|
| China | -312.0 | 2.0 | 20.0 | -59.4 | -49.3 | -15.2 | -0.3 | 2.3 | -33.3 | -1.7 | -44.8 | -140.3 | 7.9 |
| Mexico | -120.5 | 10.2 | -7.6 | -2.1 | -5.7 | 18.5 | 2.0 | 2.5 | -8.3 | -55.4 | -24.9 | -47.4 | -2.3 |
| Germany | -62.9 | 0.7 | 0.7 | -0.6 | -0.5 | -12.2 | -1.1 | -0.6 | -20.6 | -21.4 | -5.1 | -6.4 | 4.1 |
| Japan | -61.1 | 2.4 | 12.0 | -0.1 | 0.0 | 1.1 | -1.5 | 0.6 | -21.0 | -44.6 | -6.8 | -4.9 | 1.7 |
| Canada | -57.0 | -41.2 | -10.0 | 1.0 | -5.3 | 4.4 | 0.3 | -7.7 | 7.9 | -21.0 | 4.2 | 3.5 | 6.7 |
| Vietnam | -29.8 | 0.0 | 0.5 | -15.8 | -4.6 | 0.0 | -0.4 | 0.1 | -0.4 | 0.1 | -1.1 | -8.8 | 0.7 |
| South Korea | -27.7 | -0.4 | 5.7 | -1.0 | -0.3 | -0.8 | -2.1 | 0.5 | -2.0 | -20.8 | -3.2 | -7.1 | 3.9 |
| Italy | -26.8 | 0.4 | -3.2 | -4.2 | -1.3 | -2.9 | -0.6 | 0.4 | -9.8 | -3.2 | -0.9 | -2.0 | 0.4 |
| India | -26.0 | -1.2 | -1.5 | -7.6 | 0.0 | -7.2 | 0.0 | 0.1 | -1.3 | -0.6 | -0.6 | 0.9 | -7.1 |
| Malaysia | -25.3 | -0.1 | 0.1 | -1.6 | -1.3 | 0.1 | 0.0 | 0.0 | 0.1 | 0.0 | -1.1 | -21.8 | 0.3 |
| Ireland | -23.1 | 0.1 | -0.6 | 0.0 | -2.0 | -20.0 | 0.0 | 0.1 | 1.0 | 0.0 | 0.1 | -4.2 | 2.1 |
| Thailand | -17.6 | 0.1 | -1.3 | -1.6 | -0.4 | -0.8 | 0.0 | 0.0 | -1.4 | -0.3 | -1.0 | -10.2 | -0.7 |
| Switzerland | -15.5 | 0.2 | -0.8 | -0.1 | -0.5 | -13.0 | 0.0 | 0.1 | -1.6 | 0.2 | -0.8 | -3.4 | 4.3 |
| Indonesia | -11.1 | -0.7 | -0.9 | -6.0 | -1.2 | -0.8 | 0.0 | -0.2 | 0.2 | -0.1 | -0.5 | -1.2 | 0.2 |
| Israel | -11.0 | 0.6 | 0.4 | -0.2 | 0.0 | -5.7 | 0.0 | 0.0 | 0.2 | 0.1 | -0.1 | -1.5 | -4.9 |
| Russia | -8.8 | -7.5 | -0.2 | 0.0 | 0.0 | -1.0 | -1.2 | -2.0 | 0.7 | 0.5 | 0.2 | 0.5 | 1.1 |
| UK | -8.2 | -1.0 | -0.3 | -0.5 | -0.2 | -7.4 | -0.4 | 0.0 | 0.4 | -9.0 | -0.1 | -1.5 | 11.8 |
| Taiwan | -7.7 | 0.4 | 2.7 | -0.8 | -2.3 | 0.1 | -0.8 | 0.2 | -0.3 | -2.2 | -2.7 | -5.3 | 3.2 |
| Sweden | -6.3 | -0.1 | -0.2 | -0.1 | -0.4 | -0.8 | -0.5 | 0.0 | -1.7 | -1.7 | -0.3 | -1.1 | 0.4 |
| Venezuela | -6.2 | -9.0 | 0.6 | 0.0 | 0.1 | 0.6 | 0.1 | -0.1 | 0.8 | 0.2 | 0.2 | 0.2 | 0.1 |

*We consider as sizeable a level of above USD10bn deficit of the US by country and above USD5bn by sector

Euler Hermes' Protectionism Tracker

To anticipate protectionist announcements, one can calculate the bilateral trade balances by country and sector with the US. Electronic, Electric, Machinery and Equipment and Automotive are the most at risk.

Imports of Electronic, Electric and Textile from China are the largest contributors to the US trade deficit; they correspond to the list of Chinese products targeted: Industrial and electrical machinery, Optical equipment, Vehicles (railway, aircraft), Chemicals (incl. pharmaceuticals) and Metals (steel and aluminum mainly). Conversely, to track retaliation by China, Agri-food (where import tariffs have been increased on EUR3bn products) ran the largest deficit. The recent Chinese retaliatory measures have targeted Aircraft, Cars, Chemicals and Agri-food products (of which Soybeans, Cereals, Beef). Outside China, Mexico, Germany, Japan and Canada are the largest contributors to US trade deficits with Automotive, Machinery and Equipment, Electrical and Electronic equipment. Mind the deficit!

WHY THESE MAY BE TRADE GAMES ONLY

To evaluate the economic impacts of trade disruptions, we defined three scenarios based on the average tariff on imports in the US and the number of new protectionist measures (Figure 3). First, our baseline scenarios called Trade Games, corresponds to a mild increase of the average tariff by +0.5pp from 3.5% today for the US with negligible retaliation. This is the unfolding situation, following the announcements, and our most likely scenario.

Our second scenario (Trade feud) - which is unlikely - corresponds to an increase of +2.5pp for import tariffs

for the US and the rest of the world bumping them to 6% for the US and 8% globally (lingering retaliation). This scenario could also happen in case of a concentrated bilateral quarrel between the US and China if the US tariff to all imported Chinese product were to rise to 15%. The last time this level of trade disruption was observed was in the mid-80s with dozens of new protectionist measures per month.

Last, our Trade war scenario (very unlikely) corresponds to an increase of tariffs globally by +8.5pp i.e. to 12% in the US and 14% globally. The

bilateral version of it would mean a 45% tariff on all Chinese imported products, which echoes what President Trump used to say on the campaign trail. Note that this situation has not happened since the mid-60s, before the sixth round of the GATT.

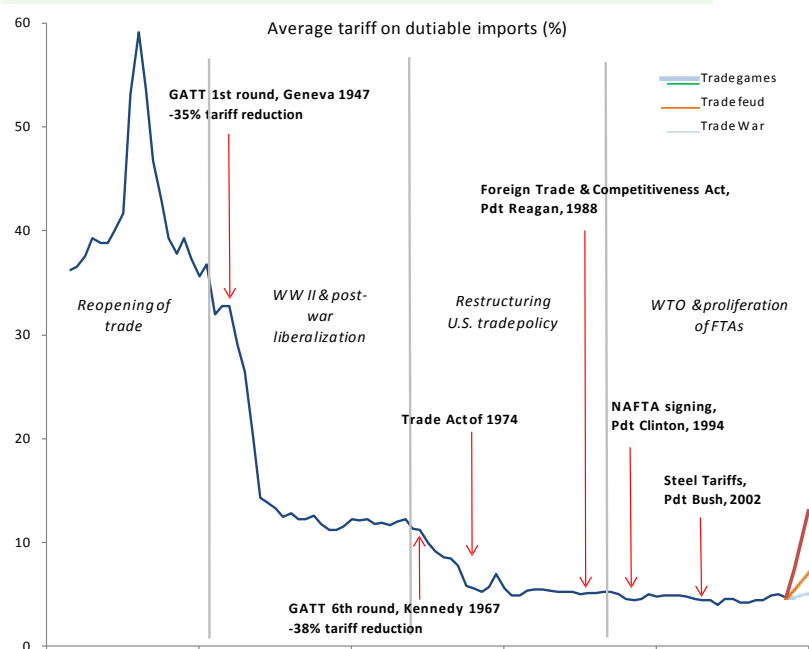
The results of the three scenarios (and their variants) are summarized in Figure 4.

In our baseline, exemptions and risks are taken into consideration in limiting the escalation but even with confirmed measures all being effective, world import tariff increase is less than +0.5pp but above +3pp for US-China bilaterally.

According to our model, this would cut US growth by -0.1 pp to +2.9% in 2018 and have a negligible impact on inflation. Domestic demand would remain strong and cause an aggravation of the current account deficit by -0.6pp and of the fiscal deficit by -1.1 pp. Europe will not be impacted; China would remain on a soft landing trajectory and emerging markets would continue to benefit from an early phase of recovery through: a (i) continued rise in commodity prices (for commodity exporters); and (ii) a sizable trade opportunities.

The main risks lie in the confidence shock causing volatility on the financial markets: The VIX index should stay below 20 on average, while US yields increase steadily to 3.2% at year-end. The US real effective exchange rate should remain broadly stable and the Fed tightening cycle on track.

Figure 3 Protectionism and average tariff on imports in the US across time



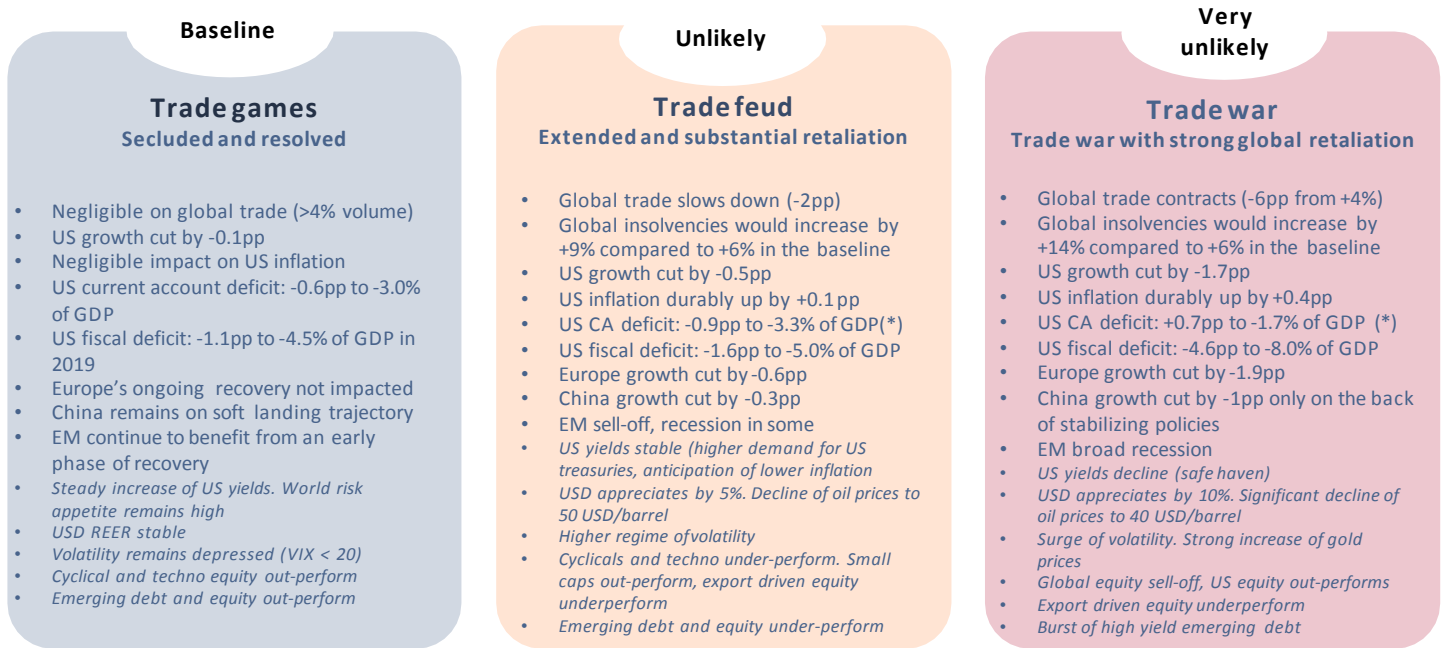
Sources: WTO, USITC, Euler Hermes

Figure 4 Protectionism scenarios

Average tariffs to increase by ~ +0.5pp (to 4% for the US) or above +3pp US-China bilaterally

Average tariffs higher by +2.5pp to 6% in the US and 8% globally or 15% against China

Average tariffs higher by +8.5pp to 12% in the US and 14% globally or 45% against China



Sources: WTO, USITC, Euler Hermes. Calculations made using model developed Barattieri, Cacciatore, and Ghironi (2017)

Based on import demand elasticities, combined export losses for US and China would amount to around USD30bn per year (see Figure 5), which represents only 0.1% of global trade of goods and services.

Mexico and Canada would lose close to USD2bn worth of exports,

mainly concentrated in Automotive, Electronic and Electric, Machinery and equipment. Japan and Germany would be next in line with -USD0.7bn and -USD0.6bn of potential export losses.

All in all, total losses would remain below USD50bn (0.2% of global

trade) which should not be a drag on global trade growth. The latter is expected to increase by above +4% in volume terms on average in 2018-19.

Global economic growth would remain strong with an increase of +3.3% in 2018.



Figure 5 Total export losses by country, USD bn
Trade games: +0.5pp increase in tariffs (*)

(*) 25% on US imports of steel and 10% on US imports of aluminum for the remaining countries; 25% on USD60bn of US imports from China and 25% on USD50bn of Chinese imports from the US and 15% to 25% on USD3bn Chinese imports from the US

Sources: Sources: Chelem, World Bank, Allianz Research, Euler Hermes

Kee, Nicita and Olarreaga (2008) Import Demand Elasticities and Trade Distortions

HOW DISRUPTIVE COULD A US-CHINA TRADE FEUD OR A TRADE WAR BE?

In our Trade feud scenario, global trade growth would slowdown (-2pp from 4% in volume terms). The US growth would be cut by -0.5pp, Eurozone growth would lose -0.6pp, China growth would be reduced by -0.3pp and recession would be registered in several emerging markets. The slowdown in global demand would trigger a fall in oil prices to 50 USD/bbl. The Fed would postpone its interest rate hikes. Looking at a scenario concentrated on US-China only, the targeted products by the US should reach a total of USD230bn (compared to the USD60bn already announced) and USD170bn by China (compared to the USD50bn already announced). The bilateral import tariffs in this scenario would reach 15% and 34% respectively. In this scenario, Eurozone losses should prove more limited thanks to increasing export market shares to both the US and China. We would expect a total of EUR3 to 4.5bn additional exports to the US and EUR2 to 4bn to China.

Biggest trade losers include: the US (-USD22.6bn), China (-USD20.0bn), Mexico (-USD8.6bn), Canada (-USD7.6bn) and Japan (-USD3.6bn) – see Figure 6. The sectors that are the most exposed are Electronic, Vehicles, Electrical and Machinery. In terms of financial markets, US yields would remain stable, the USD would appreciate by +5% and there will be a higher regime of volatility.

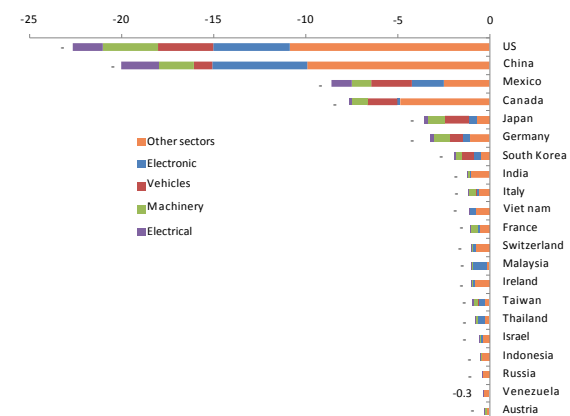
Under the Trade war assumptions, global trade growth would be cut by -6pp from 4% in volume terms. The US GDP growth would be cut by -1.7pp which could trigger an increase of +12pp in business insolvencies. Europe could be experiencing just below 0 growth (-1.9pp) which would trigger a rise in business insolvencies of +20pp. China growth would be cut by -1pp as stabilizing policies would reduce the negative impact and there will be broad recession in the emerging markets. All in all, global GDP growth would be cut by -1.5pp. The

reduction in global demand would trigger a fall in oil prices to 40 USD/bbl. The Fed would postpone its interest rate hikes and envisage rate cuts. In both scenarios, the US, China, Mexico, Canada and Japan would incur the largest export losses. Main sectors at risks include: machinery and equipment, vehicles, electronic and electrical sector.

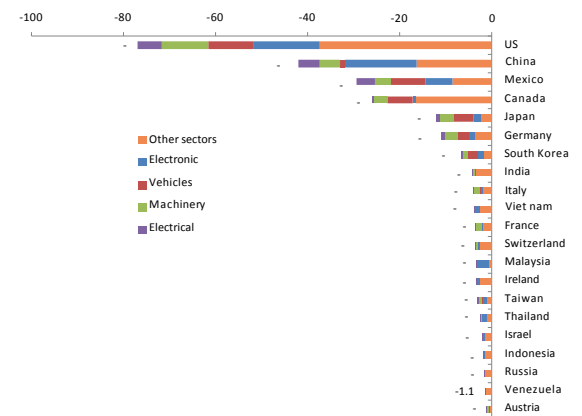
Overall, in terms of export losses the hardest hit would be the US (-USD77bn), China (-USD42.1bn), Mexico (-USD29.3bn), Canada (-USD26.0bn) and Japan (-USD12.1bn). In terms of financial markets, there will be a surge of volatility with strong increase of gold prices. The US takes over as a safe haven with US yields to decline, the USD to appreciate by 10% and the US equities to out-perform. A global sell-off on the equity markets is likely with export driven equity expected to underperform.

Figure 6a and b Total export losses by country, USDbn under trade feud and trade war scenarios

Trade feud: +2.5pp increase in world tariff



Trade war: +8.5pp increase in world tariff



Sources: Chelem, World Bank, Allianz Research, Euler Hermes. Kee, Nicita and Olareaga (2008) Import Demand Elasticities and Trade Distortions

FINANCIAL PROTECTIONISM SHOULD BE MONITORED CLOSELY

An escalation of the trade dispute between the US and the rest of the World is not related to traditional tariffs on goods only and could easily expand on existing alternative protectionism forms. While less tweeted about, other forms of protectionism (Financial, Regulatory, Data, Currency, Environmental, Sanitary, Security, and Intellectual Property) can be very disruptive.

Focusing on the financial risks of an escalation of the tensions between the US and China, the services surplus of the US with the rest of the world could be targeted. Financial activities in particular are a crucial element of the ongoing negotiations between the US and China as the US side requires further opening of the Chinese capital market. The structure of the US current account also reveals a net positive contribution of revenues generated from invest-

ment abroad. One aspect that retaliation could morph into is related to restrictions on foreign direct investments (FDI). To this regard, the US, but also Europe and China, have been particularly active by limiting FDI targeting sensitive sectors of the national economy. The CFIUS (Committee on Foreign Investment in the United States) looks into mergers implying foreign investors, which could represent a threat for national interests. Several major operations have already been blocked in 2017 and 2018 in the US (see Figure 7); German, French and Italian governments recently advocated to block unwanted FDI from Chinese origin.

In this context, China could be inclined to limit the opening of its capital market, block the access to large high tech companies to its domestic market or also envisage a reduction

of its holdings in US foreign exchange reserves, with potentially high consequences for the USD value given the fact that China is the largest holder of US Treasuries in the world.

Note that a potential devaluation of the RMB would result from a marked deterioration of trade relations between China and the US. Companies in sectors that rely on imported materials (energy, agriculture), sectors that are in overcapacity (mining and basic material) would feel the heat.

Outside China, South Korea, Japan, the US and Germany would suffer from increased competitiveness with Chinese products. High tech foreign companies would face stronger difficulties to be competitive when selling into China's domestic market but also abroad as Chinese corporates become more competitive.

Figure 7 Deals abandoned under current US President

| Target | Would-be-acquirer | Country | When killed | Deal size (mn USD) |
|----------------------------|--------------------------------|-----------|-------------|--------------------|
| Aleris | Zhongwang USA | China | Nov-17 | 1100 |
| Cowen | China Energy Company Limited | China | Nov-17 | 100 |
| Cree | Infineon Technologies | Germany | Feb-17 | 850 |
| Global Eagle Entertainment | HNA Group | China | Jul-17 | 416 |
| Here | NavInfo | China | Sep-17 | 330 |
| Lattice Semiconductor | Canyon Bridge | China | Sep-17 | 1300 |
| MoneyGram | Ant Financial Services Group | China | Jan-18 | 1200 |
| Novatel Wireless | TCL Industries | China | Jun-17 | 50 |
| Qualcomm | Broadcom | Singapore | Mar-18 | 117 |
| Xcerra | Hubei Xinyan Equity Investment | China | Feb-18 | 580 |

Sources: Committee on Foreign Investments in the US, steps up opposition to takeovers from abroad, Euler Hermes



Photo by Clay Banks on Unsplash

Director of Publications: Ludovic Subran, Chief Economist
 Euler Hermes Allianz Economic Research
 1, place des Saisons | 92048 Paris-La-Défense Cedex | France
 Phone +33 1 84 11 35 64 |
 A company of Allianz

<http://www.eulerhermes.com/economic-research>
research@eulerhermes.com



[euler-hermes](#)

[eulerhermes](#)

FORWARD-LOOKING STATEMENTS

The statements contained herein may include prospects, statements of future expectations and other forward -looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties Actual results, performance or events may differ materially from those expressed or implied in such forward -looking statements

Such deviations may arise due to, without limitation, (i) changes of the general economic conditions and competitive situation, particularly in the Allianz Group's core business and core markets, (ii) performance of financial markets (particularly market volatility, liquidity and credit events), (iii) frequency and severity of insured loss events, including from natural catastrophes, and the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) particularly in the banking business, the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the EUR/USD exchange rate, (ix) changes in laws and regulations, including tax regulations, (x) the impact of acquisitions, including related integration issues, and reorganization measures, and (xi) general competitive factors, in each case on a local, regional, national and/or global basis Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences

NO DUTY TO UPDATE

The company assumes no obligation to update any information or forward -looking statement contained herein, save for any information required to be disclosed by law