Special Bulletin

A Japanese Perspective on the International Energy Landscape (459) December 19, 2019

New Developments Regarding Brexit and U.S.-China Trade War and Their Impact on Global Economy Risks

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In the past week, new key developments came with regard to the United Kingdom's planned exit from the European Union known as "Brexit" and the U.S.-China trade war, exerting great influence on speculations about the future course of the international situation including the world economy. The two issues had played a key role in increasing uncertainties about the future course of the international situation in recent years. Market responses to the new developments indicate that market players welcomed the developments as leading global economic slowdown risks to recede.

In the general British parliamentary election on December 12, the ruling Conservative Party won a landslide victory, boosting the number of its seats in the House of Commons by 67 to 365, well over the simple majority of 325. The victory was the biggest since the party won 375 seats under the Thatcher administration in 1987, exceeding most forecasts. Conservative Party leader and Prime Minister Boris Johnson called for realizing Brexit by the end of January 2020 based on an agreement with the European Union, while the Labor Party, the largest opposition group, advocated renegotiating the agreement with the union and implementing another national referendum on Brexit. Consequently, British voters chose Prime Minister Johnson's proposal for Brexit at the end of January 2020.

Prime Minister Johnson plans to submit a Brexit agreement bill to the Parliament for consideration starting within this year. In response to the election results, the bill is well expected to be enacted to pave the way for Brexit, stalled since a 2016 national referendum, to be realized at the end of January 2020. As explained below, various challenges and uncertainties still exist about Brexit. However, the latest election results created an expectation to bring about breakthrough to the Brexit stalemate and to indicate that the United Kingdom and Europe would make a step forward. The results also led to hopes that risks would be prevented from continuing or growing amid uncertainties. Market players welcomed the election results and bought British stocks and the pound sterling. On December 12, the pound rose 2.7% to $1.35, with stock prices rising, On the New York Stock Exchange, the Dow Jones industrial average gained more than 200 points to rise back above 28,000 for the first time since late November.

Subsequently, the United States and China announced their Phase 1 trade deal on December 13. The deal requires China to substantially increase farm and other imports from the United States and structurally reform the compulsory transfer of intellectual properties and technologies, according to the Office of the U.S. Trade Representative. The United States offered to cancel a new round of additional tariffs on Chinese imports worth $156 billion planned on December 15 and lower tariffs on $120 billion worth of Chinese products from 15% to 7.5%. Hopes of the

Phase 1 trade deal grew in May but failed to come true then, leaving bilateral trade talks difficult. The Phase 1 deal came in a run-up to the United States' planned round of additional tariffs on December 15, leading to hopes that the escalation of the U.S.-China trade war would be avoided for the immediate future.

Like the abovementioned Brexit, the U.S.-China trade war entails various challenges and uncertainties. Nevertheless, market participants welcomed the Phase 1 trade deal announcement that indicated a ceasefire for the immediate future. On December 16 after the weekend trade deal announcement, the Dow Jones average soared by more than 100 points to a record high of 28,235. It rose to another record high of 28,267 on December 17. As the U.S.-China trade war has been the biggest factor behind this year's global economy risks, the Phase 1 deal mitigated concerns about the trade war's intensification and gave a strong impression that the worst scenario would be avoided for the immediate future. On December 18, the Dow Jones average remained as high as 28,239, though with a small loss of some 27 points.

Crude oil prices also rose, accelerating their uptrend that started on a decision by the Organization of the Petroleum Exporting Countries and non-OPEC oil-producing countries in early December to expand their joint production cuts from January 2020. On December 13, the key West Texas Intermediate futures contract increased to $60.07 per barrel, rising back $60/bbl for the first time in five months excluding September 16 when it soared above $60/bbl in the wake of attacks on Saudi oil facilities. On December 17, the WTI price rose close to $61/bbl. The front-month Brent contract also rose to $66.10. On December 18, WTI leveled off to $60.93/bbl and Brent to $66.17/bbl. As global economy risks receded, hopes of oil demand growth (improvement in supply and demand fundamentals) and money flow into risk assets (a financial factor) apparently contributed to the oil price hikes.

In this way, the new developments regarding Brexit and the U.S.-China trade war have exerted great influence on market participants' perception of global economy risks, looming as key factors for anticipating the international situation, the world economy and international energy markets from next year. Future developments regarding the two issues will influence the international situation. While market players have welcomed the avoidance of worst scenarios for the immediate future, various challenges still linger regarding the two issues.

Although Brexit itself has become almost certain to come at the end of January 2020, challenges are expected to remain afterwards. In a transitional period after Brexit, the United Kingdom will have to negotiate a free trade agreement with the European Union and a framework of their future relations. Usually, such difficult negotiations take several years. However, Prime Minister Johnson has indicated a plan to complete the negotiations by the end of 2020 without extending the transitional period. The plan is dominantly viewed as difficult to implement. If the negotiations fail to produce any agreement, problems and confusions similar to those accompanying Brexit without agreement may arise. Concerns about such problems and confusions brought about the pound's rapid fall on December 17, indicating that the situation was not stable. While the Conservative Party achieved a dominant victory in the House of Commons election, the Scottish National Party that advocates Scotland's independence won 47 of the 59 seats for Scotland. The SNP is expected to demand that a referendum be implemented on Scotland's independence again. The referendum may attract attention. The Brexit issue has caused not only such divide in Scotland but also divides between urban and rural regions and between various classes in Ireland. It is unpredictable how these divides would affect the United Kingdom and Europe.

The Phase 1 deal that amounts to a ceasefire in the U.S.-China trade war is seen as a compromise between various factors including the planned U.S. presidential election, China's economic slowdown and its political stability. Both countries reportedly have groups that doubt or criticize relevant government positions and the deal itself. Depending on how the deal is implemented, the two countries could escalate their trade war again through punitive tariff hikes. Issues left pending after the Phase 1 deal include China's state-run company and industrial subsidy reforms. It may be very difficult for China to resolve or compromise on such politically sensitive issues. Given that the U.S.-China trade war originated from structural issues regarding their rivalry for global supremacy, no optimism can be warranted about the future course of their trade talks. Therefore, we will have to closely watch future developments regarding Brexit and the U.S.-China trade war without any prejudgment, after the latest developments contributed to mitigating global economy risks.

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