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U.S.-China Trade War Shifting to New Phase on 90-Day Freeze on Tariff Hike

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The U.S.-China war attracting global attention is shifting to a new phase. After U.S. President Donald Trump met with his Chinese counterpart Xi Jinping on the sidelines of a summit of Group of 20 major economies in Buenos Aires on December 1, they announced their agreement to a conditional 90-day freeze on a hike in additional U.S. tariffs on Chinese products worth $200 billion. The agreement means that the United States would freeze a plan to raise the additional tariffs on Chinese imports worth $200 billion from the present level of 10% imposed since September 24 to 25% on January 1, 2019. If the plan were implemented, the United States would have imposed 25% additional tariffs on Chinese imports worth $250 billion in total in three stages since the beginning of this year.

While the United States shelved the tariff hike, China agreed to import massive U.S. products including farm, energy and manufactured goods (immediately implement farm imports) and promptly launch structural talks on intellectual property protection, technology transfer requirements, nontariff trade barriers, cyberattacks, services, agriculture and other key background factors behind the U.S.-China trade war, according to the U.S. side. The United States vowed to raise the additional tariffs to 25% unless the structural talks produce agreement by the 90-day deadline.

The world had been watching whether the U.S.-China summit would produce any compromise on the trade war or come to a rupture. Market participants had expected to see serious negative effects on the U.S. and Chinese economies and the global economy if the summit came to a rupture in a manner to escalate the trade war. While they had been excessively sensitive to global economic risks, whether the summit would produce any agreement or compromise and details of such potential agreement or compromise had attracted attention as the most important point for anticipating the future global economy.

The U.S. decision to shelve the tariff hike indicated that the two countries agreed to temporarily avoid the escalation of their trade war or the worst development. Market participants might have been relieved to see the summit result.

However, the result can be interpreted as indicating that the two countries avoided the worst development of the trade war escalation only temporarily and only delayed the resolution of the problem for 90 days. Of the two conditions for the 90-day freeze on the tariff hike, China's import of massive U.S. products including farm goods and energy, though not so simple or easy, may be easier for the Chinese side to implement. Probably, specific measures may be announced and put into action at a relatively early date. The other condition of an agreement in the bilateral structural talks may be very difficult to meet. Intellectual property protection, technology transfer requirements, nontariff trade barriers and cyberattacks are all fundamental, deep-rooted problems. It may not be easy for China to accept compromise or offer any solutions or improvements to these problems. Furthermore, the 90-day deadline for the bilateral agreement at the structural talks can be viewed as a high hurdle.

While various comments have been made on the latest U.S.-China agreement, numerous experts view the accord as representing a considerable Chinese concession. If so, the Chinese side might have been in a situation where it was willing to avoid the tariff hike and the escalation of the trade war. Amid the escalation up to this point, the Chinese economy has seen serious problems such as the stock market weakness, the Renminbi's depreciation and capital flight. If economic deceleration becomes even more serious, undesirable developments for the Xi regime may arise. In this sense, the latest agreement might have relieved China.

As noted above, however, the structural talks are a tough challenge put under the short deadline of 90 days. A crucial stage is coming for China. Bilateral bargaining and the fate of the future structural talks will attract global attention. After the summit with the Chinese leader, President Trump appreciated the meeting as productive and amazing but reaffirmed his tough plan to implement the tariff hike if the structural or trade negotiations end in failure. At the same time, Trump said the freeze on the tariff hike would end in 90 days unless it is extended, indicating that the freeze could be extended.

Difficult structural and trade talks will be carried out toward and after the turn of the year. Depending on their results, market participants could be forced to get prepared for global economic risks again. For anticipating the international situation in 2019, the U.S.-China structural talks may be the most important point. This is the same case with the international energy situation. In the international oil market in which crude oil prices have declined remarkably in response to increasing inventories and global economic risks, the presence or absence of global or Chinese economic deceleration and the magnitude of such deceleration will exert great influence on the oil supply-demand balance and prices.

If the Chinese economy decelerates, such development's impact may not be limited to the oil market. China exerted great influence on the supply-demand balance in the international LNG market by rapidly expanding LNG demand from the second half of 2017. China's natural gas/LNG demand is the greatest matter of interest to LNG market participants on the demand side. In global coal trade as well, China's import expansion changes have induced wild fluctuations in spot coal prices in past several years. The Chinese economy's potential deceleration will exert grave influence on oil, gas, LNG and coal markets. The Chinese deceleration would also affect electricity demand growth through drops in industrial production. Future economic developments may influence investment in renewable energy and nuclear power generation and the selection of electricity sources in China. Given that China is the world's largest energy consumer, the fate of the U.S.-China trade war and its impact on the Chinese economy will surely have great influence on China's and the world's energy markets.

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