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EXPERT TALK

A "5-minute" walk-through about what's happening in the market 6 July 2018

Protectionism intensifies while negotiation continues

After several months of hesitation, President Donald Trump finally decided to implement some of his protectionist threats, first against the EU, Canada and Mexico; then more recently, with China. As a base case, Amundi expects limited tariffs will be implemented on different fronts with relatively controlled macro impacts while talks continue. Although talks have become more contentious, we do still see space for negotiation among the various parties. This is the main difference vs a proper "trade war".

Do you see higher risks of escalation regarding current trade disputes?

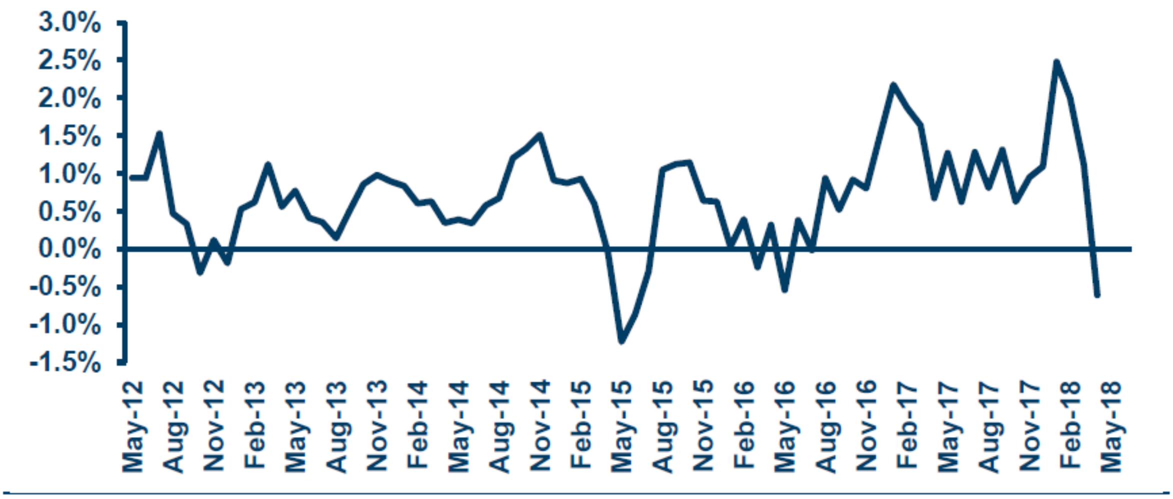
Didier Borowski: Our central scenario remains that tariffs will be implemented on a limited basis on different fronts with relatively controlled macro impacts while talks continue. Although talks have become more contentious, we do still see space for negotiations among the parties, and this is the main difference vs a proper trade war. However, recent developments, plus the high approval rating of President Trump, which encourages him to remain "offensive" on trade, have increased the tail risk, which relates to the potential breakup of talks. This could result in a serious spiraling path of retaliation, with significant negative effects on global trade, financial markets and, therefore, the world economy.

What could be the implications on the current economic outlook of the protectionist threats? What if a trade war were to materialize?

Didier Borowski: The risk of a global trade war could impact GDP growth well before it begins. Trade tensions between the US and most of its partners have already begun to weigh on business confidence (particularly in Germany, the most exposed European country to world trade) and on trade momentum. Uncertainty now risks weighing on business investment, even before global trade is affected by measures, some of which may never be put in place. That said, in our central case scenario, we continue to believe that the impact of protectionist measures on world trade will be modest and that global economic expansion will continue in 2018 and 2019. The worst-case scenario (outright trade war) would likely lead to recessionary pressure on the world economy.

Protectionist measures have a negative impact on the global economy, including on the country imposing them. US auto exporters, for instance, would likely suffer from a reduction in the demand (European retaliation) and higher input costs (tariffs on materials). The strength of the impact would be initially proportional to the size of tariffs implemented, but above a certain threshold, the impact would be more than proportional as a consequence of implicit/not official measures adopted.

World trade momentum



Source: World trade momentum: last 3-month average volume on preceding 3-month average volume. Source: Amundi, CPB World Trade Monitor, April dataset. As of 22 June 2018.

What would you expect from US-China talks?

Qinwei Wang: We expect, as a central case, limited tariffs to be implemented, with relatively mild macro impacts while talks continue. From China's perspective, policy has been relatively consistent, delivering some reforms and further openings (cut to import tariff on autos and some consumer goods and opening of Auto and Financial sectors to foreign investors). Moreover, China's policy stance is expected to be further fine-tuned to guard against a moderate slowdown. Despite short-term noise, on a medium-term perspective, it appears that President Trump's protectionist pressures might lead to deeper integration of China with other EM that are keen to diversify risk away from the uncertainty related to US policy and to embrace China's Belt & Road initiatives. With regard to tail risk, should disputes escalate, the damage to global trade and China could be significant. As a rough estimate, we believe that the 25% tariff on USD 50bn of products would knock around 0.1pp off China's GDP growth (while a 10% tariff on USD 200bn could shave off an additional 0.2pp). Nonetheless, there is still the chance that the US and China could reach certain deals which could result in a decline in concerns about potential tariffs and other protectionist measures.

What could be the implications of a rise in trade-related issues on equity markets and what equity strategies/sector/markets could hold better?

Eric Mijot: A real trade war is not our base case and would be painful for all stock markets. An escalation of tensions could indeed disrupt the chain of value creation which is currently very international. In theory, US companies may regain some competitiveness vs others, but there would also be a negative impact on input costs and margins. At the regional level, our preference in equities is still for the US. In Europe, the UK should do better than the Eurozone.

Within EM, if global trade growth slows significantly, closed economies will suffer less. In EM Asia, we prefer India and Indonesia, both growth stories with good equity fundamentals. Also in terms of sectors, we think it is better to stay on the domestic side, i.e., with consumer sectors and even Financials - also in this case mainly in EM Asia, where the Chinese economic rebalancing between investment and consumption is continuing. Assuming that the dispute, at least in the short term, will mainly involve the US and China, in the short term, the countries most exposed to these two countries (Vietnam, Taiwan, Colombia, South Korea, Malaysia) could be more vulnerable.

What is your view on EM equity in the current environment of trade tensions?

Patrice Lemonnier: Trade tensions are negative for emerging markets as they tend to push global inflation and US rates higher, reduce the willingness to invest, and could negatively weigh on the exports of some countries. Within EM, China and Mexico are the main targets, but Western allies have not been spared. The extent to which emerging economies with be affected will ultimately depend on actual measures and potential escalations. But, we believe that China, which exports the equivalent of 3% of its GDP to the US, has the capacity to take internal economic measures (especially monetary) to mitigate any negative impact. Countries that are commodity exporters in EM are not directly affected. However, the strength of the US dollar, which is exacerbated by US trade sanctions, as well as potentially marginally weaker economic growth in EM could weigh on commodity prices.

Regarding the Sino-US negotiations on trade, we do expect structural frictions, given increasing levels of competition on technology. Yet, both parties should at some point understand that they both may lose from departing too abruptly from the current order of global business. In any event, we believe the US will not be able to prevent China from becoming a global technology leader. The capacity of China to invest in R&D and to benefit from the large economies of scale, stemming from its huge market size, will continue to work in its favour in the medium term.

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