ECONOMIC NEWS

Will There Be a Trade War?

Economic events over recent weeks suggest that we are on the brink of a trade war. The first salvos were fired by the United States, with the Trump administration imposing customs tariffs on washing machines and solar panels in January, and steel and aluminum in March, followed by the recent announcement of possible tariffs on specific Chinese products. In addition, there are the possible reprisals to these measures, in particular from China. Do we need to fear an escalation?

Clearly, there is nothing positive about these developments. The financial markets are well aware of this, while the stock market drops when protectionist fears rise. Last year, we argued in an Economic Viewpoint that the rise in protectionism will have an adverse impact on economic conditions in the United States and elsewhere.

However, it is important to remember that the measures announced up until now are fairly modest from a macroeconomic point of view. The temporary exceptions regarding steel and aluminum granted to Canada, Mexico, the European Union and other countries significantly lessen the impact of the measures. The tariffs targeting China that remain to be specified are expected to affect products worth US$60B, while the trade deficit the United States has with China for goods reached US$378B in 2017. Chinese reprisals concerning pork, aluminum, wine, and other U.S. products are expected to add up to US$38B. Clearly, it would have been better to have avoided this situation.

What would be the cost of a real, widespread escalation? The rise in trade restrictions could only limit economic growth in addition to feeding inflationary risks. A Bloomberg analysis estimated that a 10% increase in the cost of imports into the United States, followed by an equivalent response on the part of the rest of the world, would create a 0.5% drop in global GDP in 2020 compared to a baseline scenario. The negative impact would be 0.9% in the United States, 0.5% in China, 0.3% in Germany, 1.0% in Mexico and 1.8% in Canada. The International Monetary Fund (IMF), for its part, estimates that a 10% increase overall in the cost of imports for all countries would reduce global GDP by 1.75% after five years and nearly 2% in the longer term. The World Bank estimates that raising average tariffs worldwide from the current 2.7% to 10.2% would reduce global GDP by 0.8% over three years. These estimates differ, but they all point in the same direction: there is a net cost to protectionism.

IMPLICATIONS

Of course, irritating factors exist in global trade. Among them, the preponderance of Chinese products and the problems associated with intellectual property. However, it is clear that triggering a trade war is not the right remedy, and it will not lead to a stronger or healthier economy. On the contrary, a decline in global trade will cause the economy to slow down and new doubts to arise on the financial markets. Whether it’s the United States, China or any other country, no one will come out a winner in this war. At this point, we have not factored in a trade war in our baseline scenario.

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