Economics

DBS Flash

Growth implication of a full-blown trade war

Group Research

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- *It may still be unlikely, but given the global dynamic, it is time to consider the downside scenarios around a full-blown trade war.*
- *It has taken its time, and global growth indicators are still strong, but we are beginning to see the first signs of real damage from trade wars.*
- *An all-out trade war, under which all goods traded between China and the US are subject to 15-25% tariffs, would hurt the two economies' GDP growth rates mildly (quarter percent) in 2018 and substantially in 2019 (more than half percent).*
- *This would set off a major global chain reaction. Given their trade open-ness and exposure to the electronics supply chain, there will no respite whatsoever for Malaysia, Singapore, South Korea, and Taiwan in this tail risk scenario.*
- *Contrary to popular perception, we think trade wars will hurt the US more than China.*
- *This is because China will retaliate on multiple fronts, and also because simultaneous fights with Canada, EU, and others would affect US consumers and businesses disproportionality.*

It is time to think of tail risks. While we still think that a full-blown trade war is unlikely, the harsh rhetoric and punitive measures have reached a point that warrants serious consideration of such eventualities.

These are early days, but signs of real damage have begun to surface with announcements of postponed or redirected investments. To be sure, backward looking data still paint a comfortable picture with respect to global consumption and trade, but we think the chance of upside surprises to the forecast have waned considerably.

Here are some markers on how the trade war is beginning to have negative impact:

- Capex intention surveys have reflected businesses voicing concerns over tariffs and market access barriers in the pipeline.

- In the US, the recent decline in the NAHB homebuilder sentiment index reflected concerns over rising Canadian timber prices due to recently imposed import tariffs.

- Fed Chair Jerome Powell recently highlighted that, for the first time in this cycle, decisions to postpone investment are being mentioned by business owners, along with postponement of hiring.

- The escalation in trade skirmishes, combined with soft global growth momentum (outside of the US) and US monetary policy tightening could add to further woes on emerging markets, as evidenced by recent price action.

An all-out trade war, which we define to be 15-25% tariff on all products that are traded between China and the US, could shave off ¼% of GDP to both economies' GDP outturn this year, while the damage would be far greater in 2019, with both countries looking at ½% or more of GDP downside. Considering that China grows at 6-7% and the US at 2-3%, we believe the damage would be greater to the US than on China.

Below we provide our estimate of downside risk to GDP forecast for key economies:

Real GDP growth, yoy %	2018		2019	
	Forecast	Downside risk	Forecast	Downside risk
US	2.60	0.25	2.50	0.60
China	6.60	0.25	6.20	0.60
Malaysia	5.00	0.60	5.00	1.30
Singapore	3.00	0.80	2.70	1.50
S Korea	2.90	0.40	2.90	1.00
Taiwan	2.80	0.60	2.40	1.20

Why would the US be hurt more, when China exports much more (goods exports of USD505bn in 2017, compared to importing USD130bn from the US the same year)? Two key reasons feature into our rationale:

- First, China's retaliation will most likely extend to beyond goods to trade in services and to the operation of US companies on mainland China.

- Second, the US is pursuing trade wars on multiple fronts, extending the skirmish against its ostensible allies like Canada and the EU. In each skirmish the US targets different economies and consumers, but the retaliation from each counterpart falls on the same group of American consumers and businesses. The reckoning is in the pipeline, in our view.

For China, trade tensions are compounding a multitude of domestic challenges, ranging from deleveraging to money market liquidity. We see the Jun 24 RRR cuts reflecting that policy priorities have shifted from "deleveraging" to "risk precautions" and "growth support". Our Nowcast framework shows only a mild slowdown in Q2 (we are tracking 6.7% growth), but there is a general sense of unease, manifesting in higher borrowing costs, weaker RMB, and investment slowdown. We believe China will stand up to the US in the ongoing trade skirmish, but there should be no question that there is no positive to this saga; China's businesses and consumers will be hurt by higher tariffs and other trade barriers. For the rest of Asia, given the trade open-ness and exposure to the supply chain, there will no respite whatsoever for Malaysia, Singapore, South Korea, and Taiwan in this tail risk scenario.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and