

# Equity-Based Insurance Guarantees Conference

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When an unstoppable force meets an  
immovable object: The US/China trade war

Aziz Sunderji

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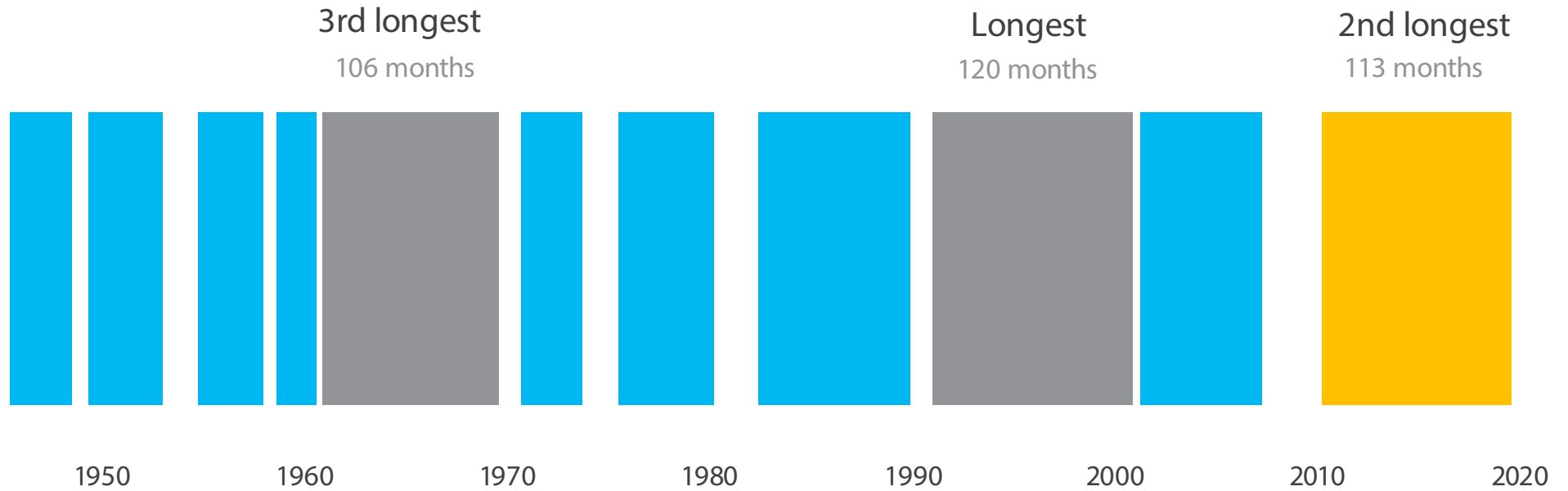
When an unstoppable force meets an  
immovable object:

## The US/China trade war

November 2018

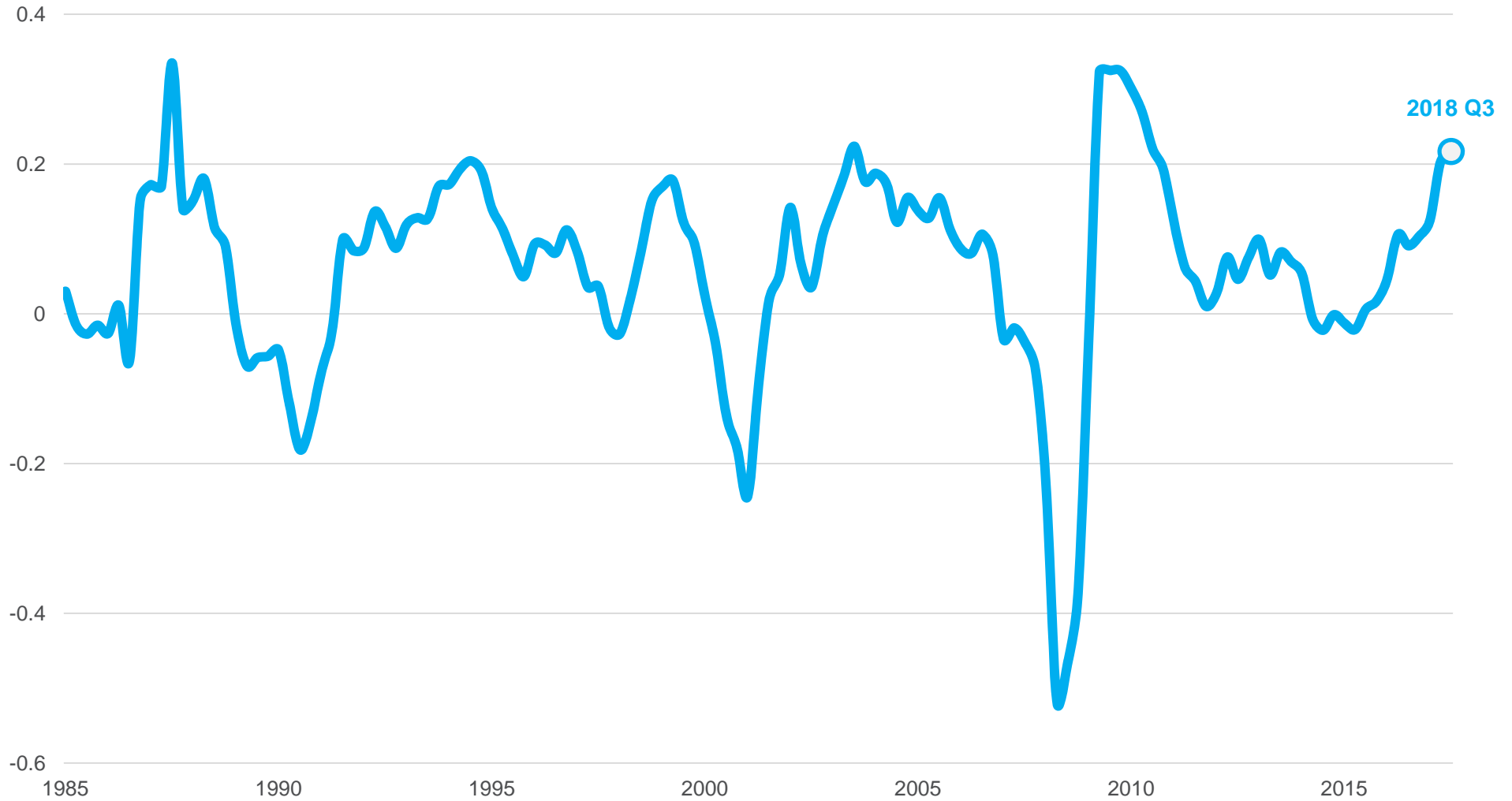
# It was the best of times

This is one of the longest expansions in US history



# Companies making hay

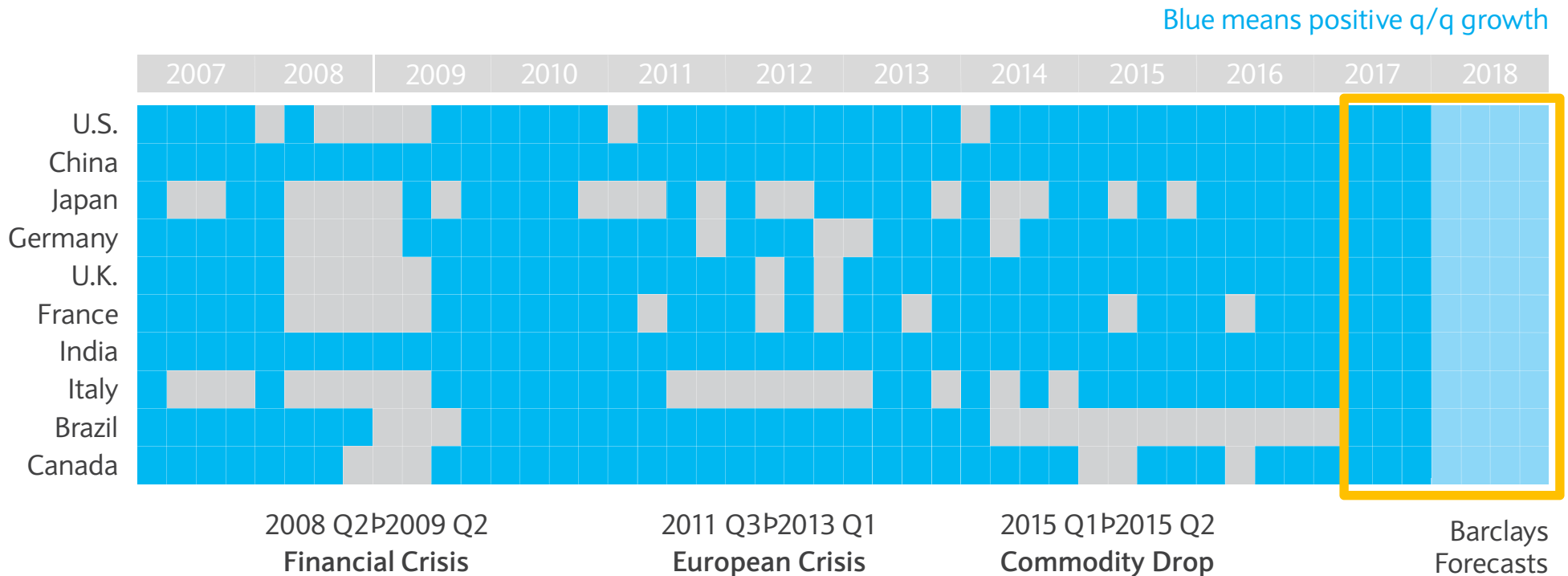
y/y seasonally adjusted growth rate of earnings for S&P 500 companies



Source: Bloomberg, Barclays Research

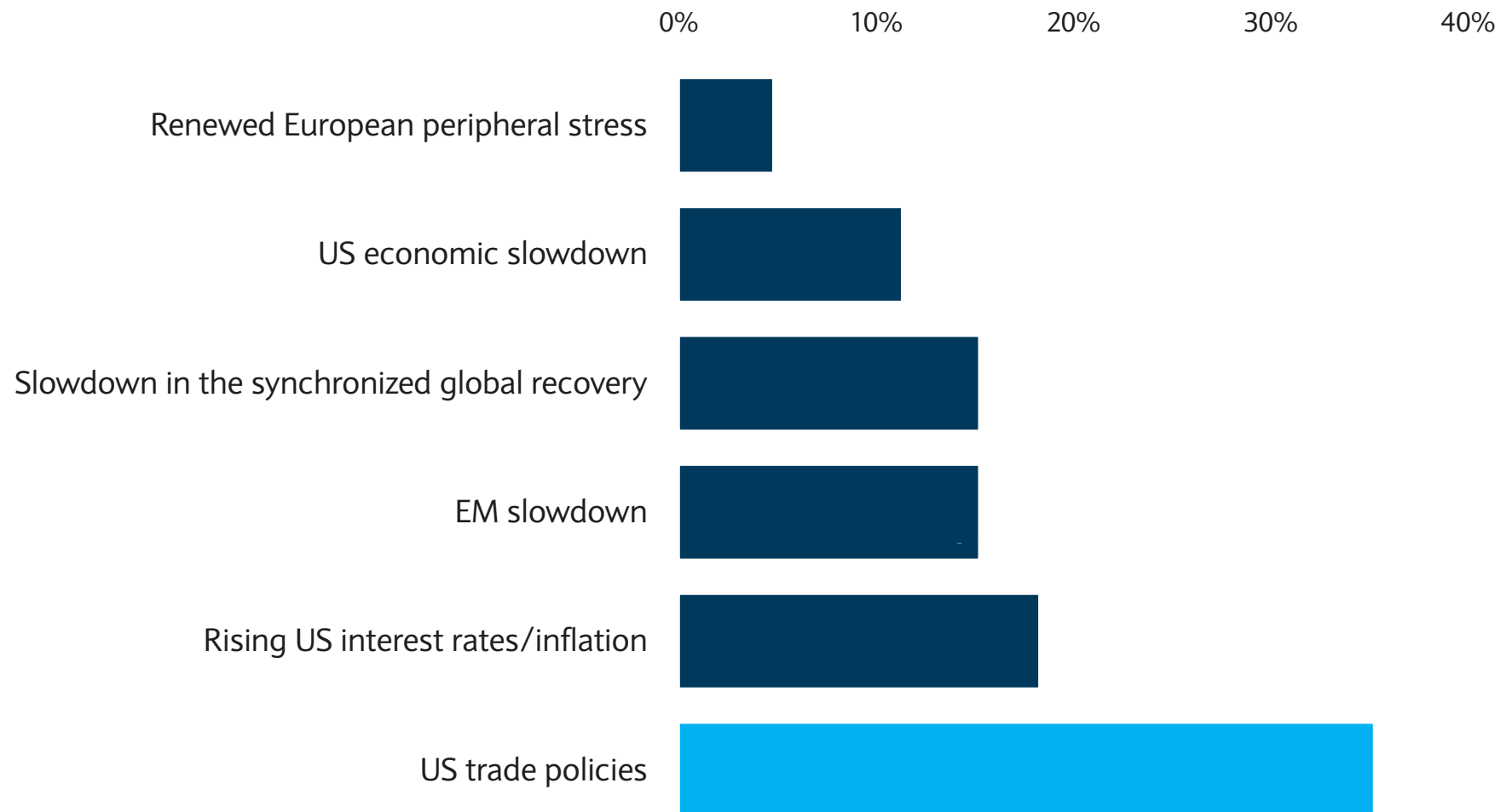
# And world growth in a rare moment of synchronicity

The world's major economies are now growing in sync



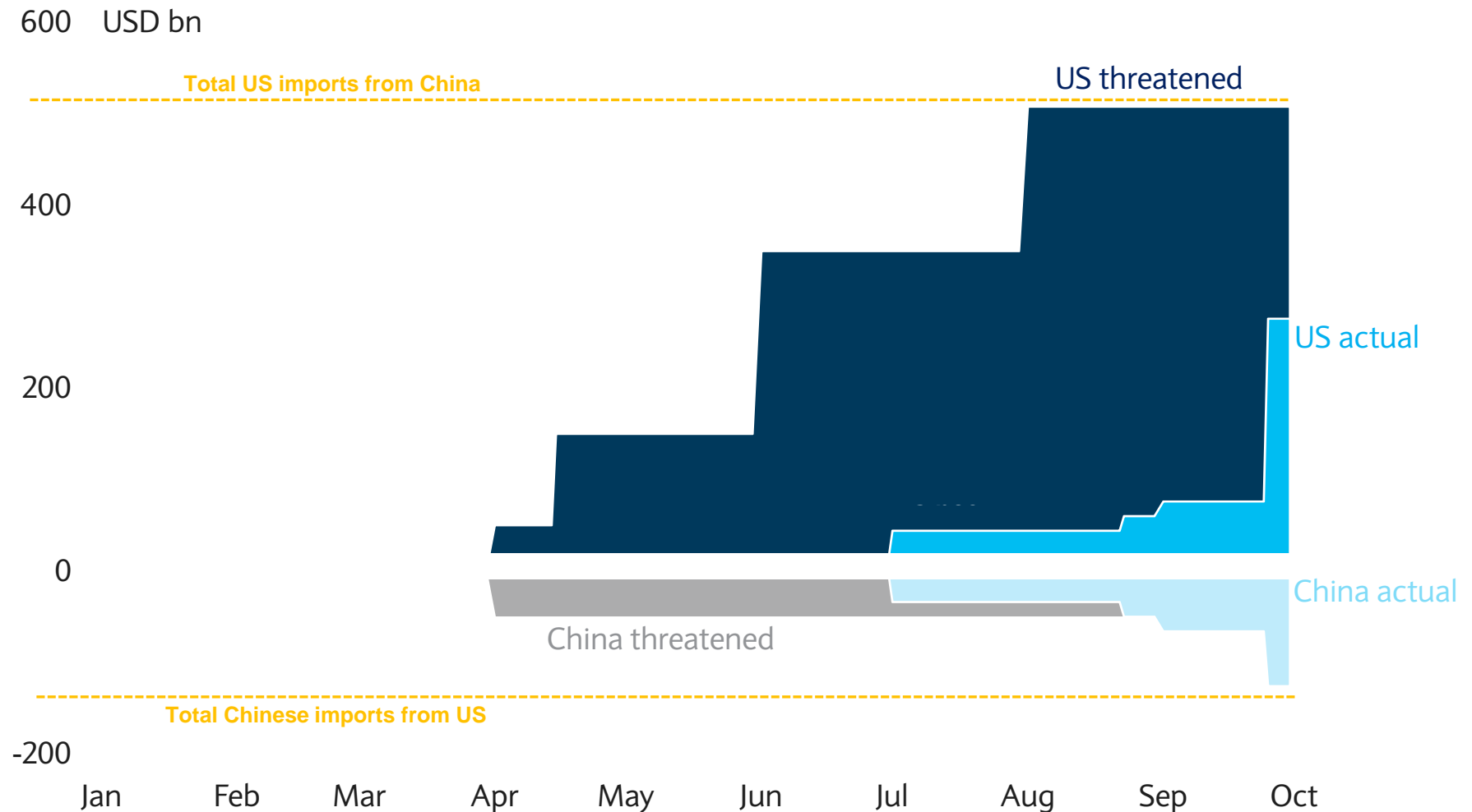
# What could possibly go wrong?

Barclays Global Macro Survey polling of equities investors



# That escalated quickly

Actual tariffs are rapidly catching up with threats



Source: PIIIE, Barclays Research

# What's driving US tariffs on China?

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Three key motivations

1. The trade deficit
2. China trade practices
3. Politics



# What's driving US tariffs on China?

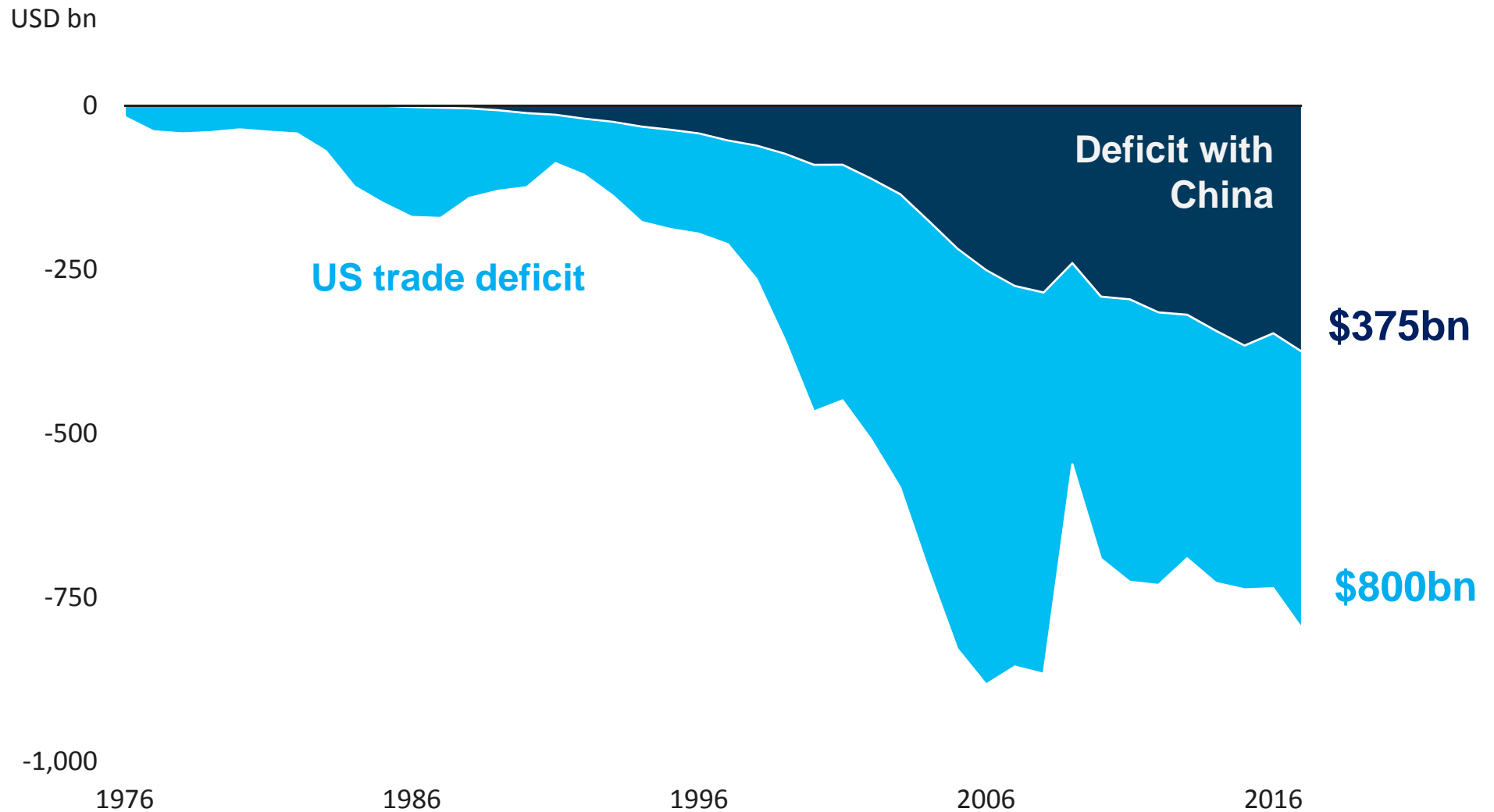
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Three key motivations

- 1. The trade deficit**
2. China trade practices
3. Politics

# The trade deficit has soared

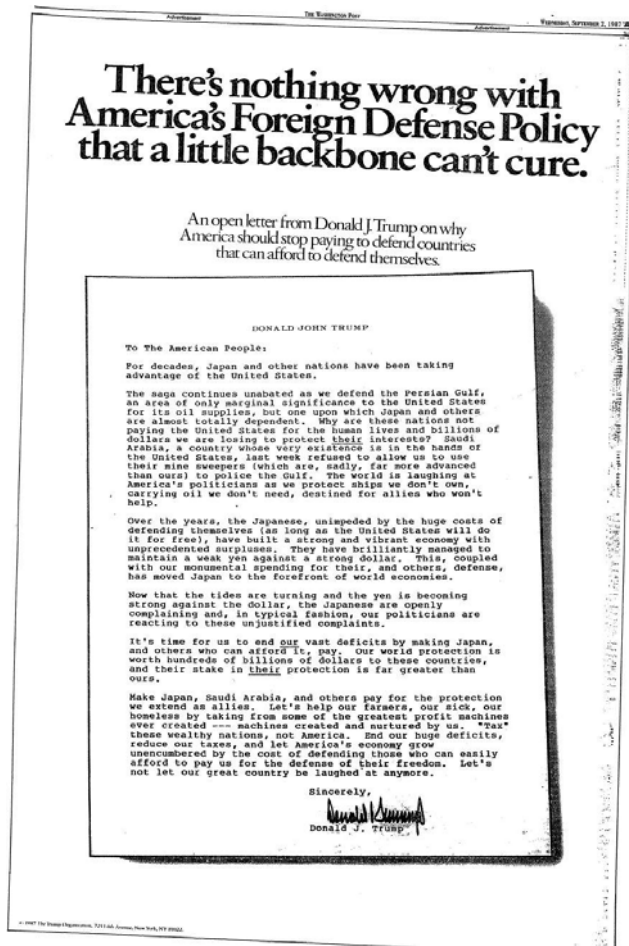
China accounts for half of it



# Trump separates trade policy from other objectives

## Evidence from the (failing) New York Times

New York Times, September 2, 1987



*"..the Japanese, unimpeded by the huge costs of defending themselves (as long as the United States will do it for free), have built a strong and vibrant economy with unprecedented surpluses.."*

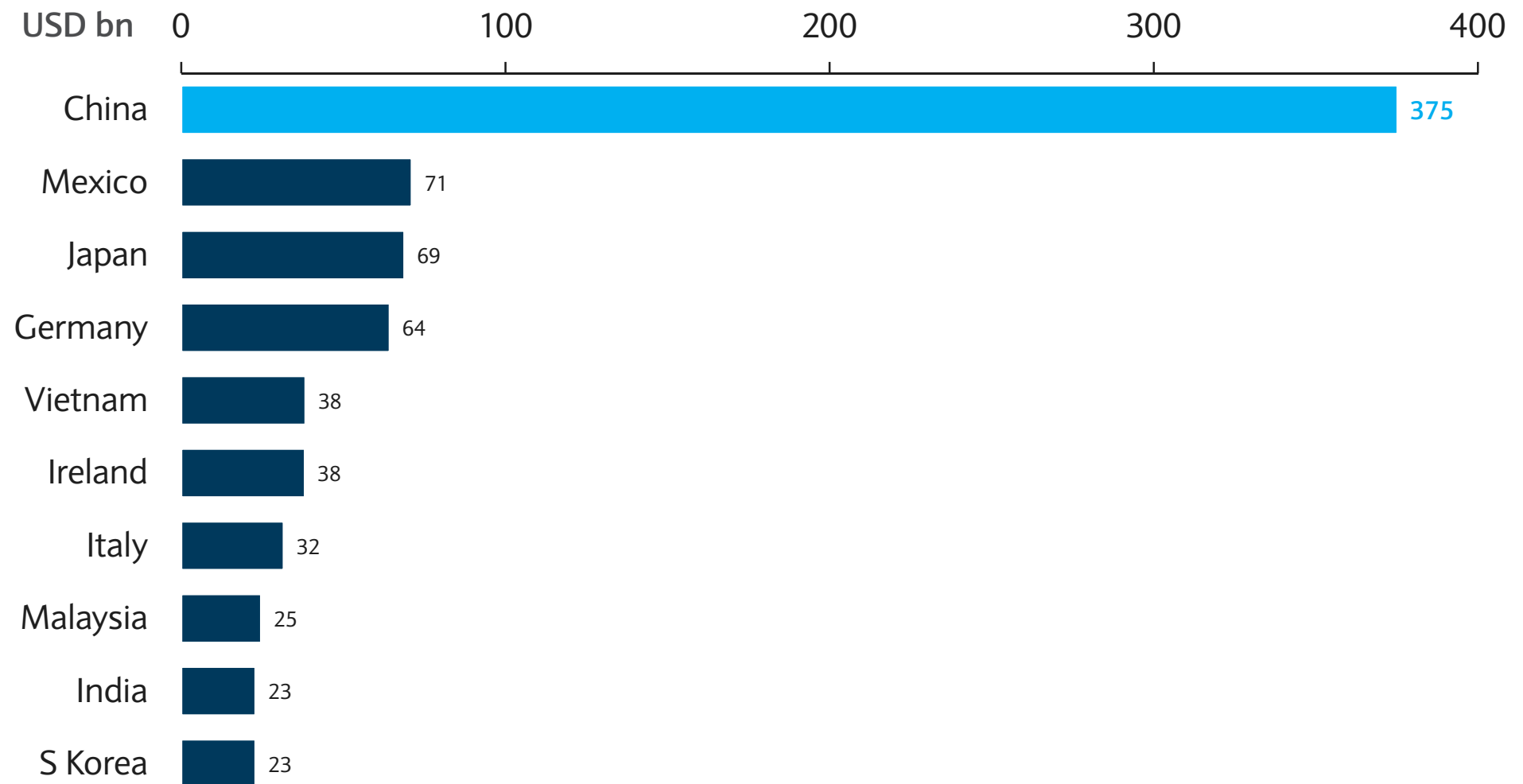
*"It's time for us to end our vast deficits by making Japan, and others who can afford it, pay. Our world protection is worth hundreds of billions of dollars to these countries, and their stake in their protection is far greater than ours...."*

*"Make Japan, Saudi Arabia, and others pay for the protection we extend as allies. Let's help our farmers, our sick, our homeless by taking from some of the greatest profit machines ever created --- machines created and nurtured by us. "Tax" these wealthy nations, not America. End our huge deficits, reduce our taxes, and let America's economy grow unencumbered by the cost of defending those who can easily afford to pay us for the defense of their freedom. Let's not let our great country be laughed at anymore."*

Source: New York Times, Barclays Research

# The deficit with China dwarfs all others

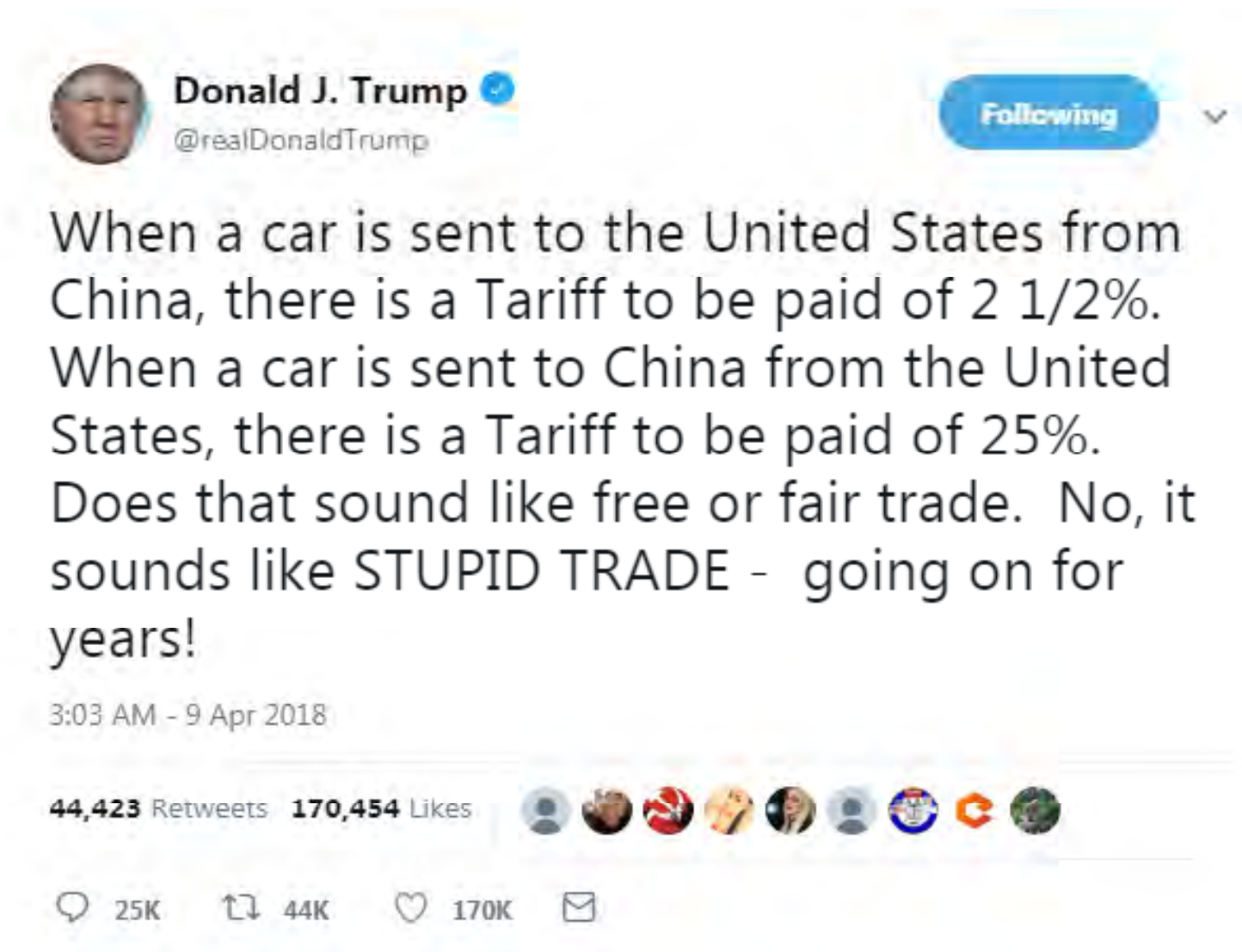
Next nearest is one fifth the size



Source: WTO, Barclays Research

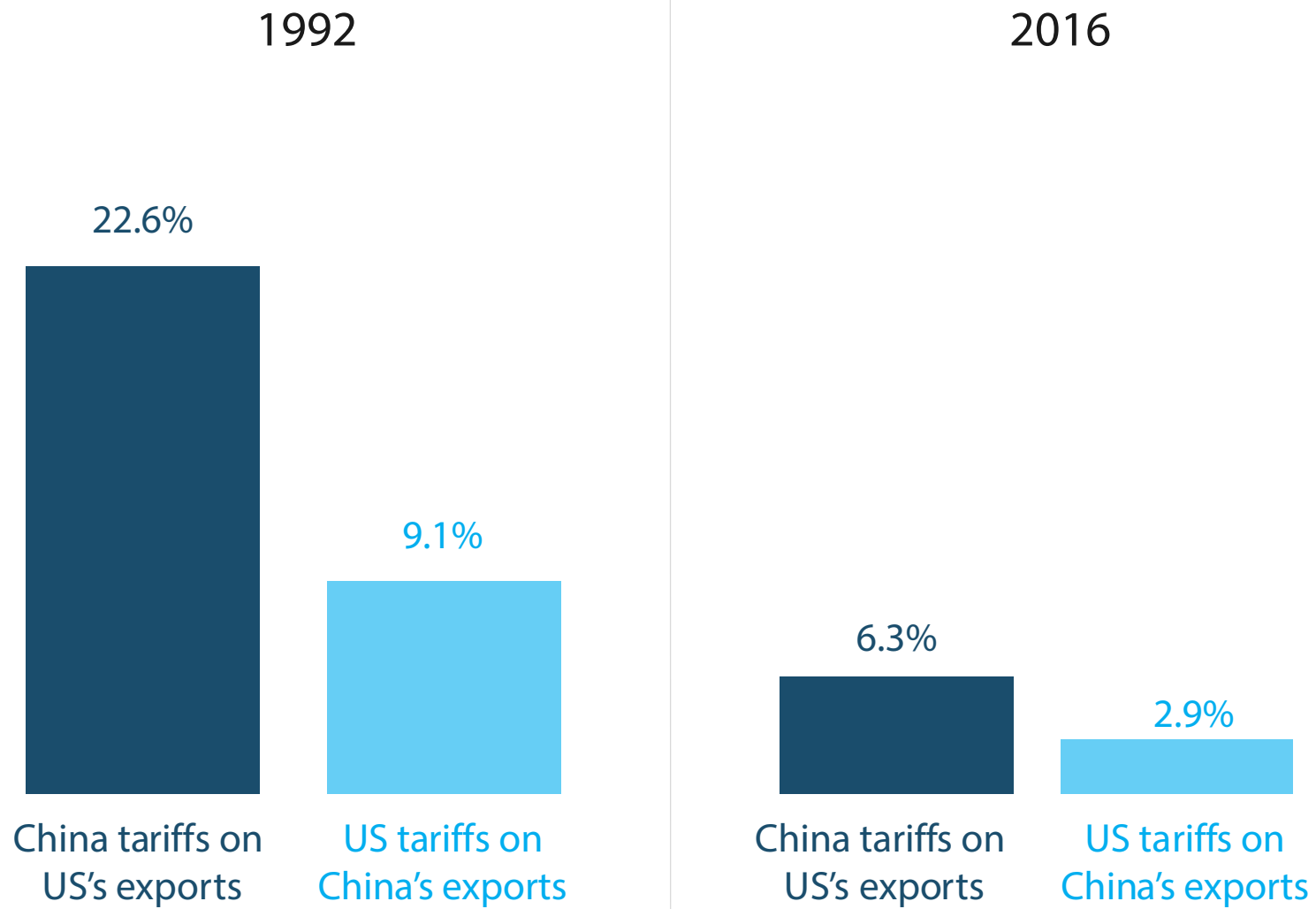
# The administration blames unequal tariffs

In 270 characters



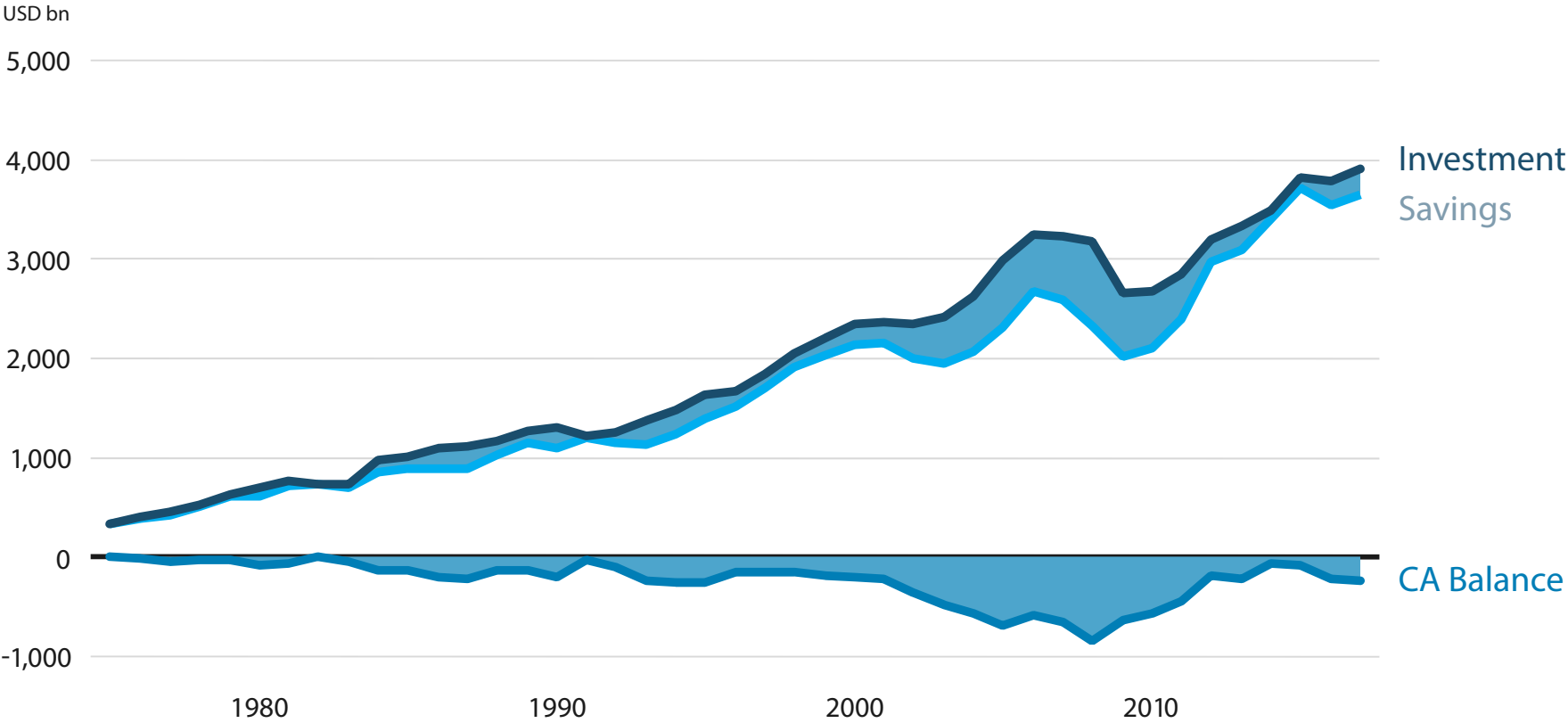
# Are the terms of trade really uneven?

Tariffs on both sides much lower than before, but still not even



# But the deficit isn't due to these uneven terms of trade

The deficit reflects a macroeconomic imbalance between savings and investment



Source: Haver Analytics, Barclays Research

# Cross country evidence

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Countries which save too little run current account deficits

## Current Account Balances and Savings/Investment for Selected Major Economies, 2017

Country	Current Account Balance, % of GDP	Ratio of Gross National Savings to Total Investment
Germany	8.1%	141.7
Japan	3.6%	115.3
Russia	2.8%	111.9
China	1.4%	103.1
France	-1.1%	95.2
India	-1.4%	95.4
Brazil	-1.4%	92.1
Indonesia	-1.7%	95.1
United States	-2.4%	88.5
United Kingdom	-3.6%	79.0

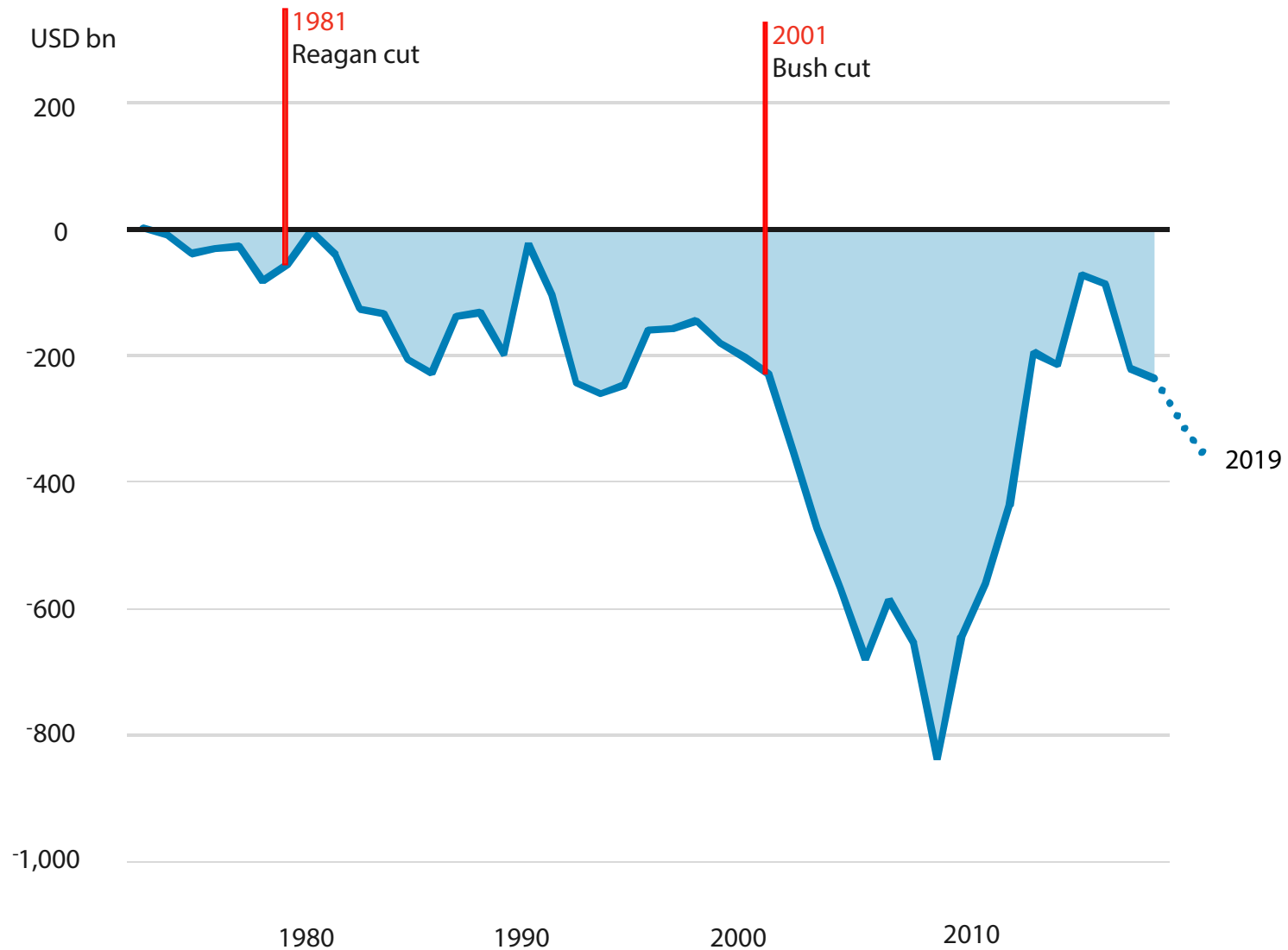
**Source:** IMF, World Economic Outlook database, October 2017.

**Notes:** Data for 2017 are estimates.



# The deficit will probably get worse

That's what happens when fiscal stimulus turbo-charges growth



Source: Haver Analytics, Barclays Research

# What's driving US tariffs on China?

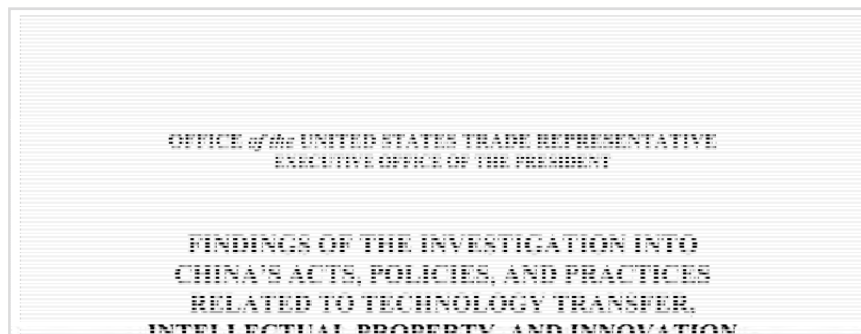
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Three key issues

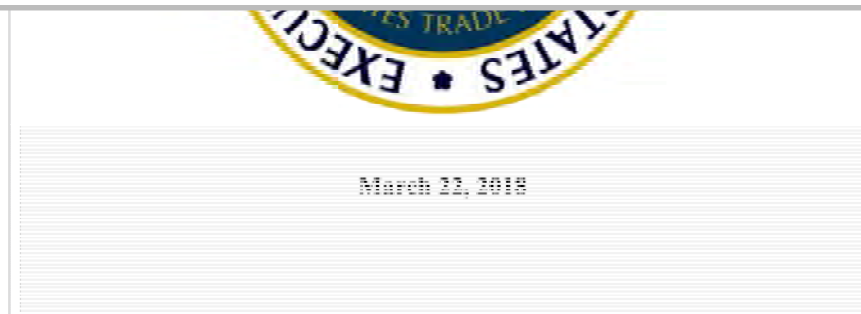
1. The trade deficit
- 2. China trade practices**
3. Politics

# USTR 301 report

## China practices unfair trade



First, the Chinese government uses foreign ownership restrictions, such as formal and informal JV requirements, and other foreign investment restrictions to require or pressure technology transfer from US companies to Chinese entities. These requirements prohibit foreign investors from operating in certain industries unless they partner with a Chinese company, and in some cases, unless the Chinese partner is the controlling shareholder. Second, the Chinese government uses its administrative licensing and approvals processes to force technology transfer in exchange for numerous administrative approvals needed to establish and operate a business in China.



# Made in China 2025

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## Industrial development plan



Made in  
China

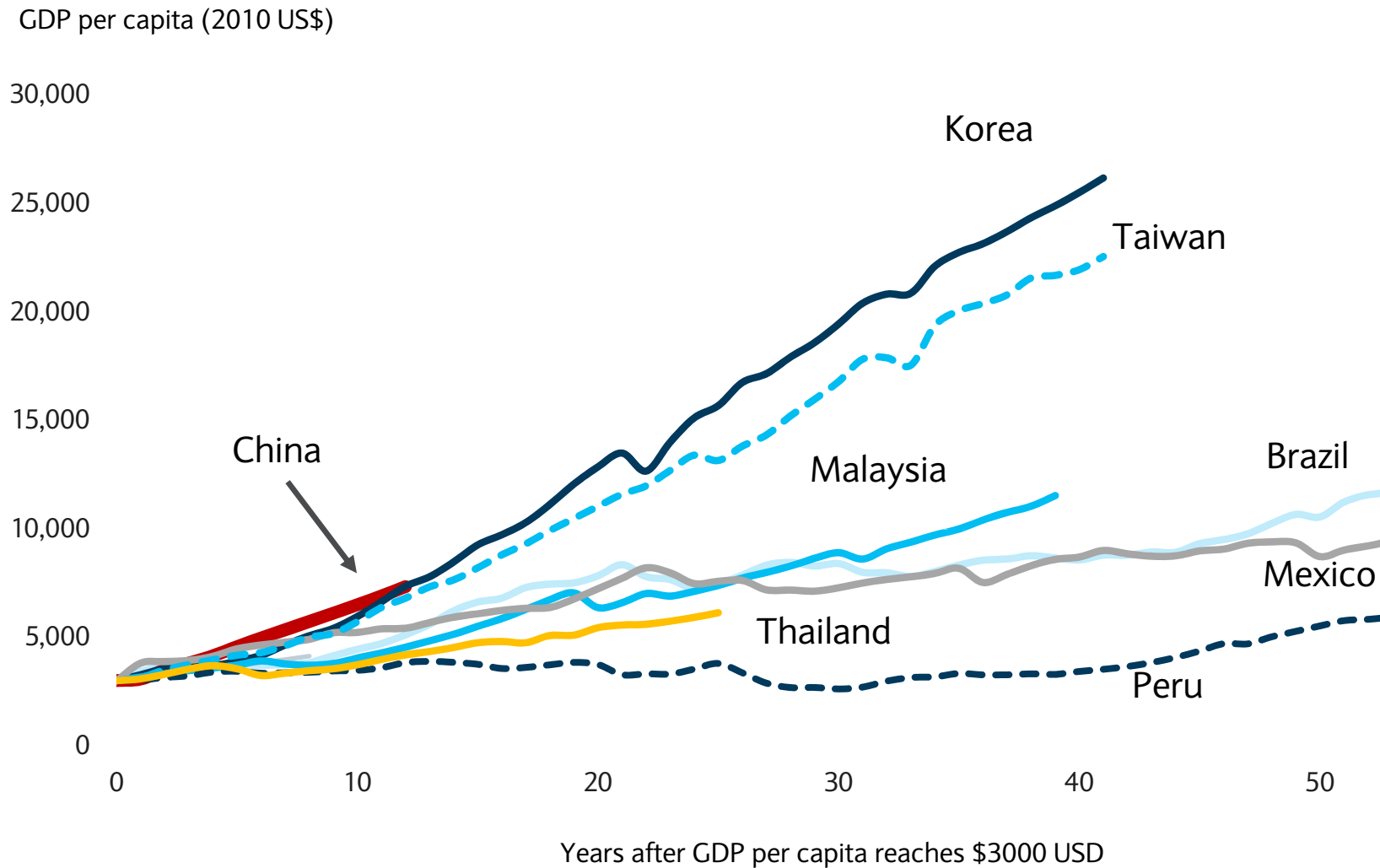
— 中国制造 —

2025

Encourage the overseas transfer of high end equipment, advanced technology and strong industry.

# China wants to avoid the middle income trap

Development tends to stagnate at \$3k per capita

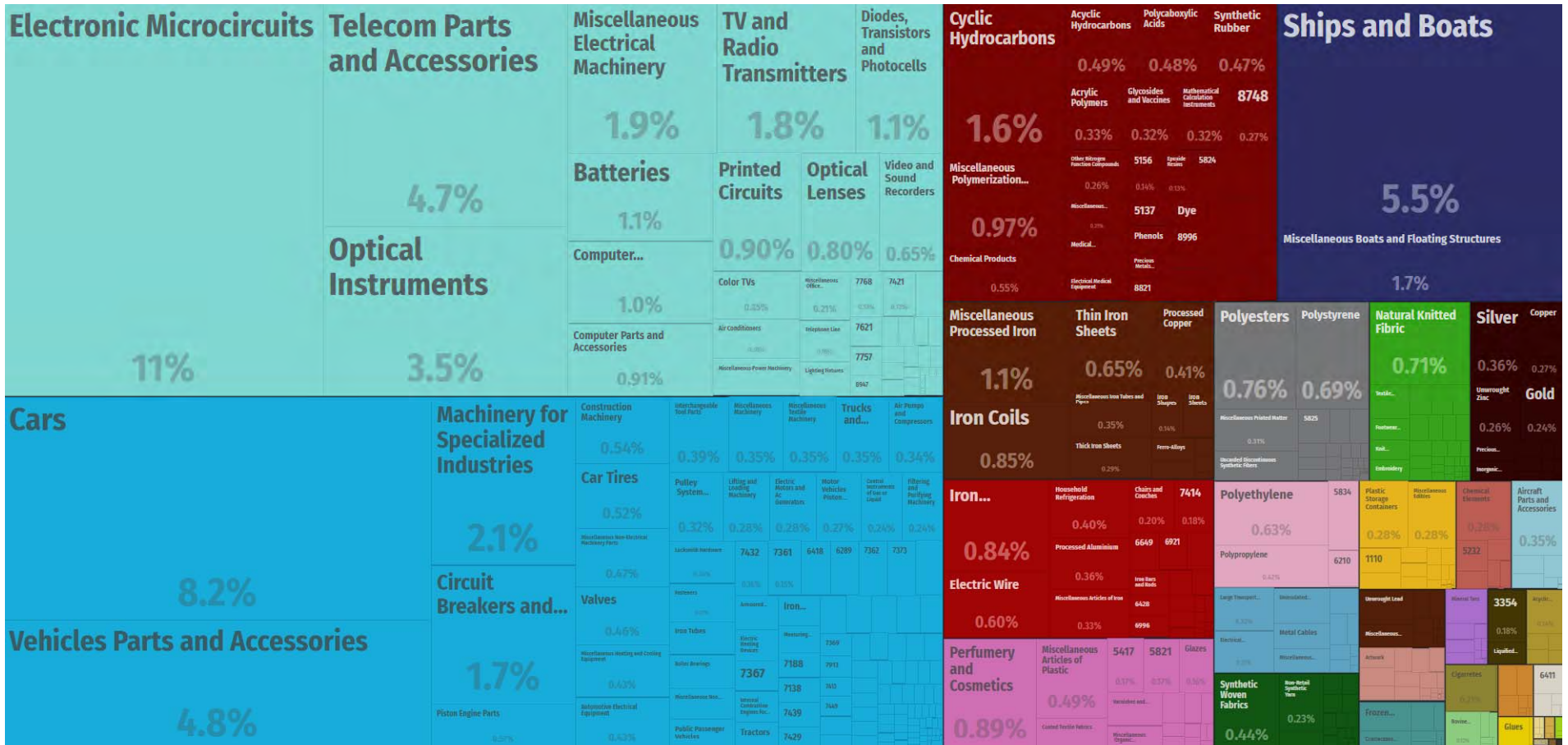


Source: Haver Analytics, Barclays Research

# How did South Korea escape the middle income trap?

Switched from low value add to high tech

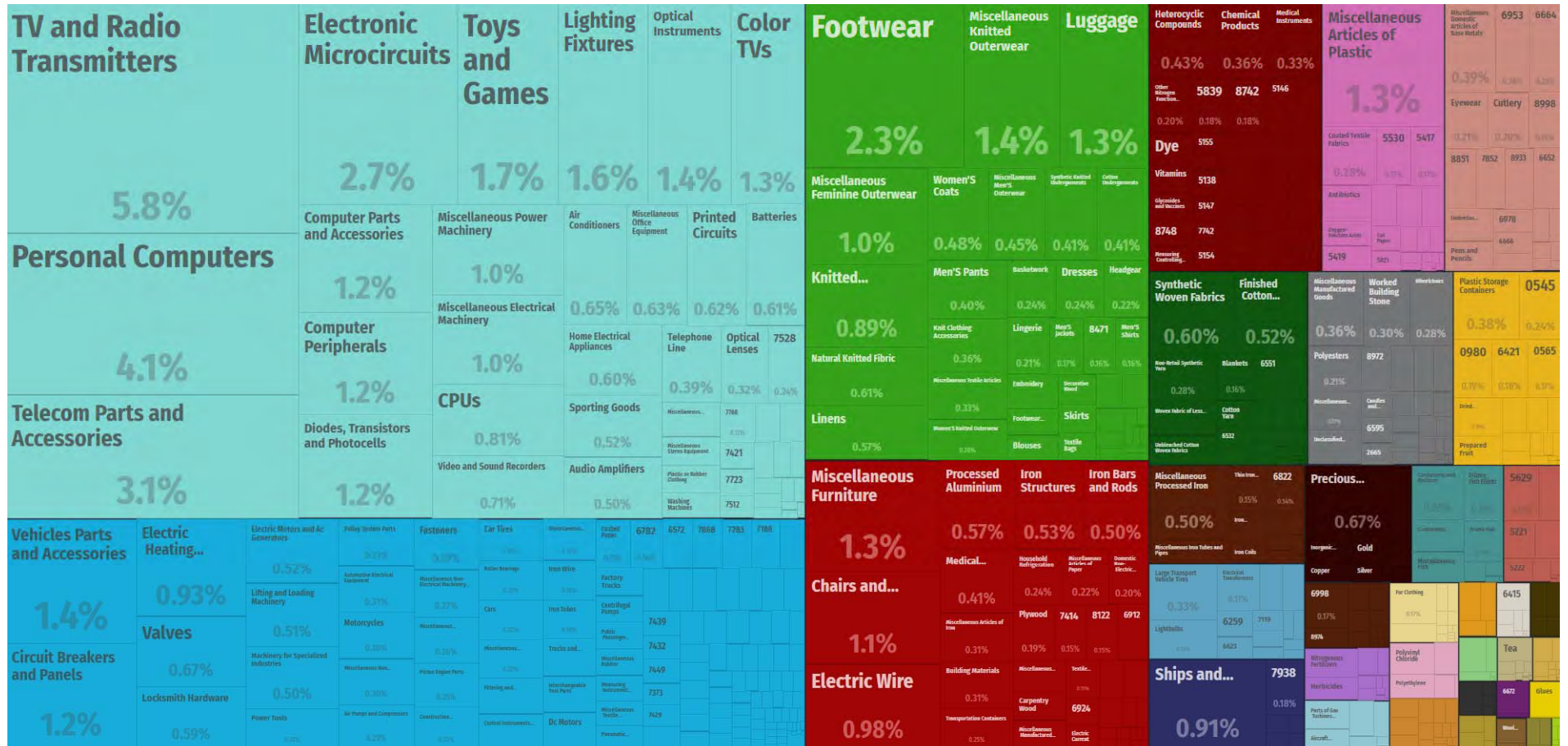
2016



# China is in the midst of this transition

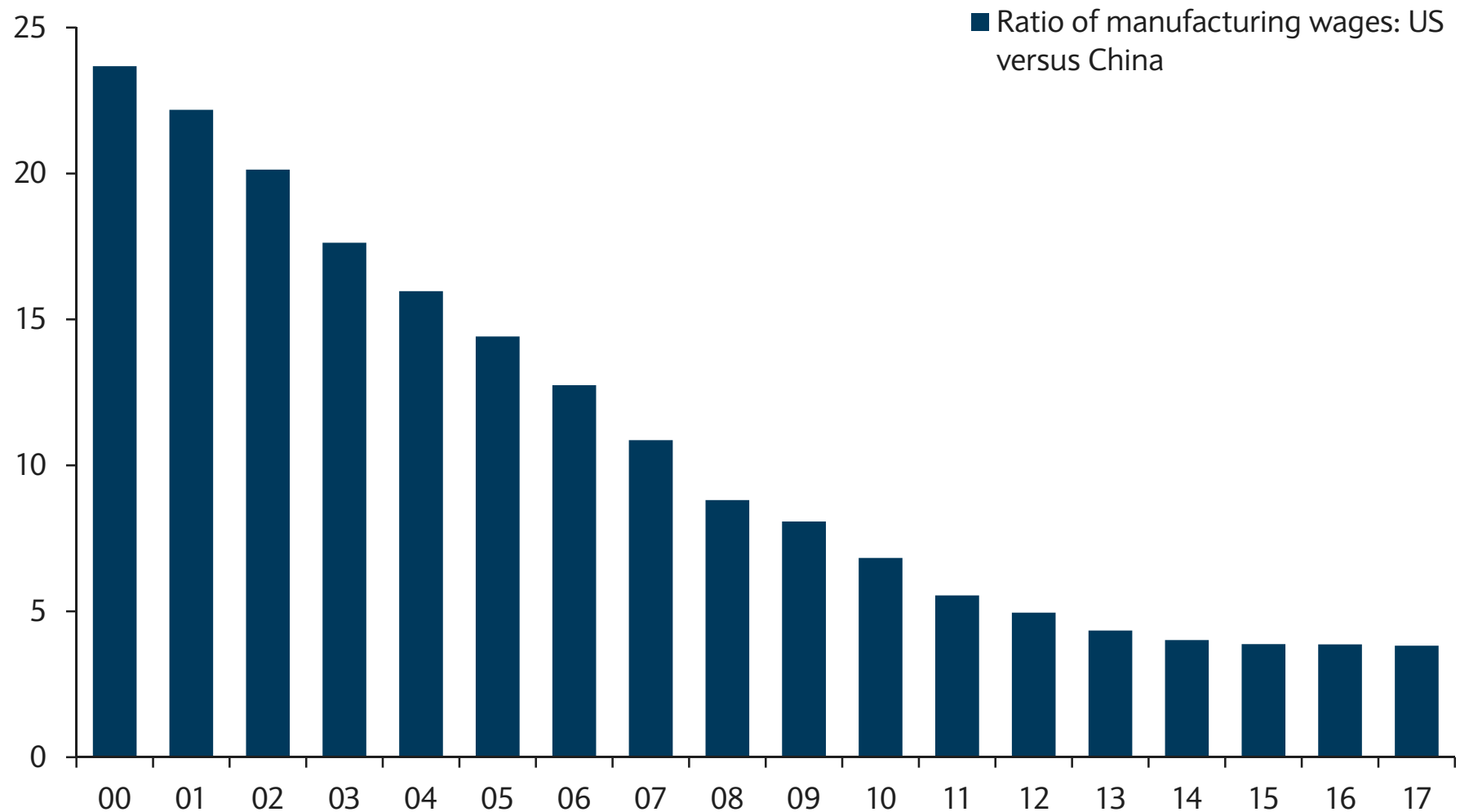
And wants to continue

2016



# China's low cost of production advantage has been partly eroded

## Wages in the US versus China



Source: Haver Analytics, Barclays Research



# What's driving US tariffs on China?

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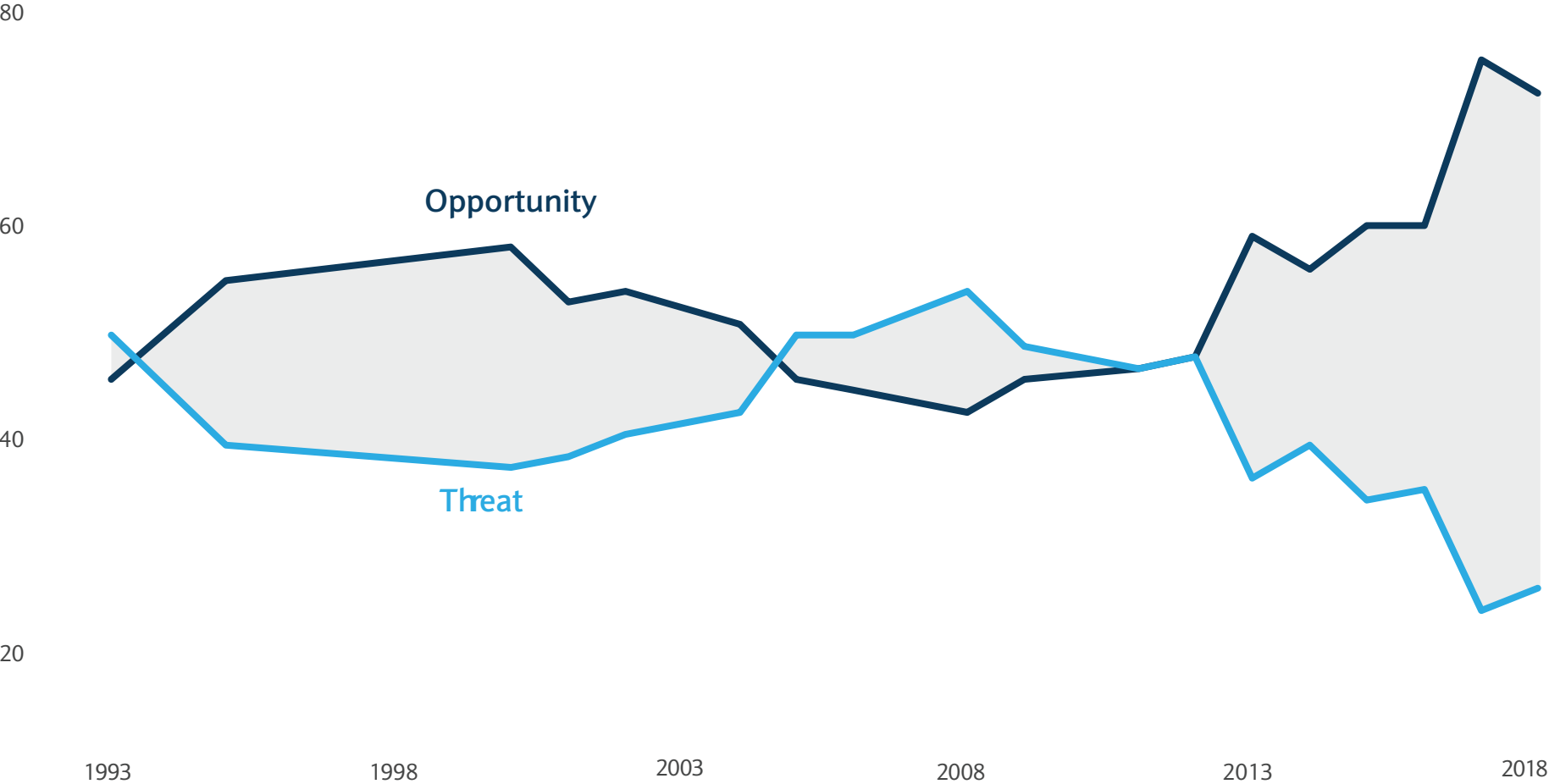
Three key issues

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- 3. Politics**

# In the abstract, Americans are free traders

A big majority think free trade is more of an opportunity than a threat, and by more than ever...

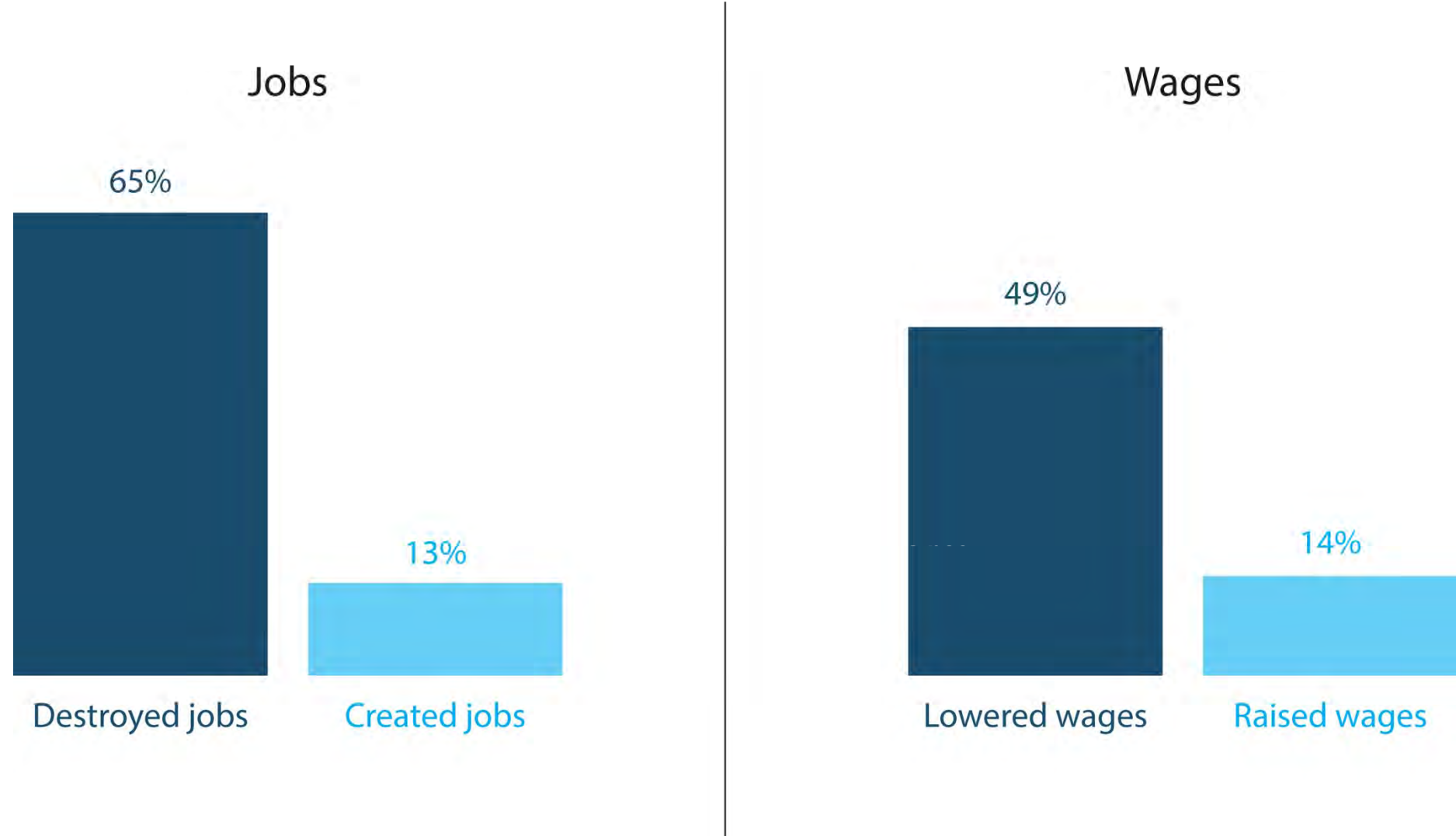
% of respondents



Source: Pew Research, Barclays Research

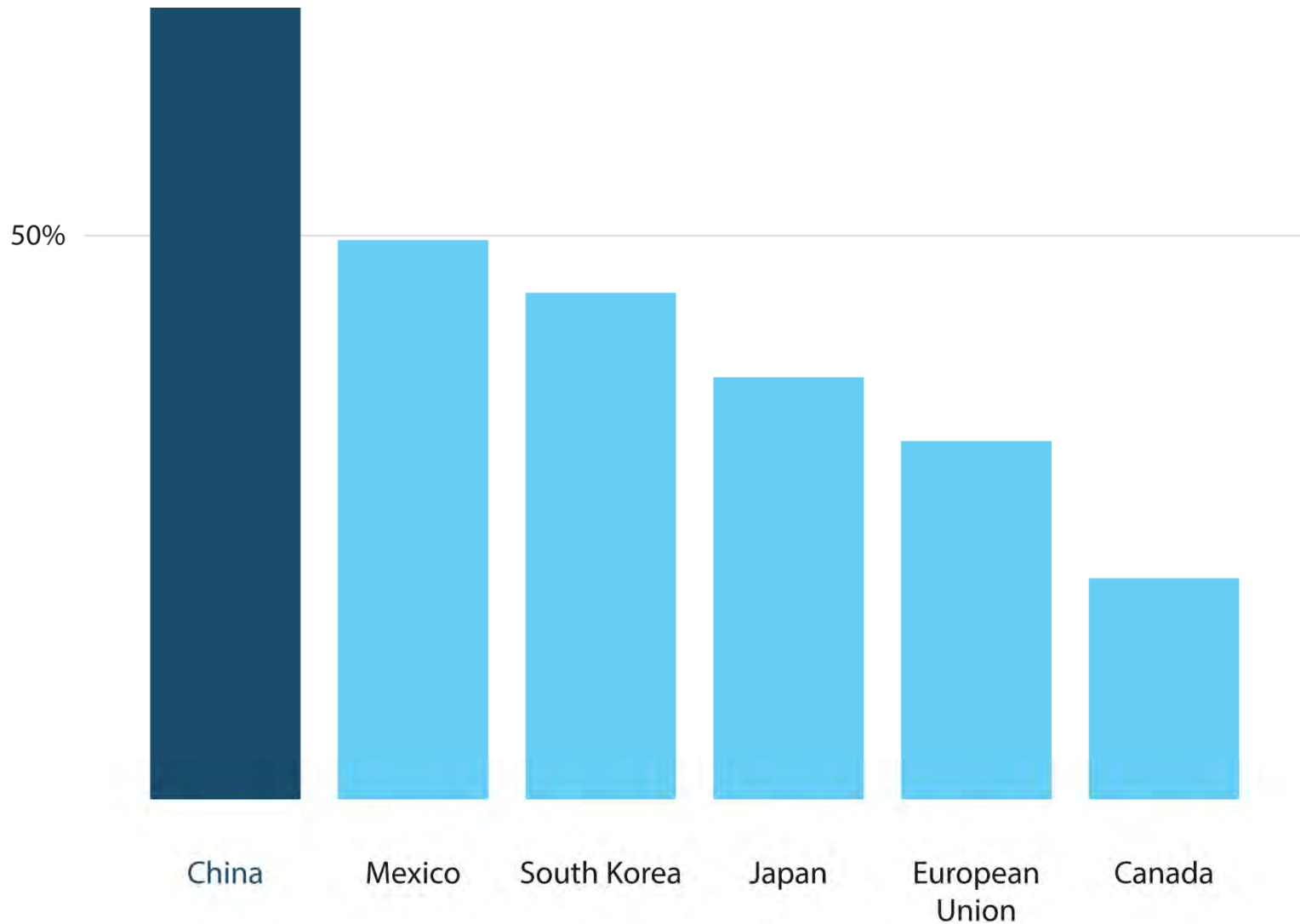
# But don't like what trade has done to jobs and wages

Killed jobs, depressed wages



# They think China cheats the most on trade

Which countries 'cheat' on trade?

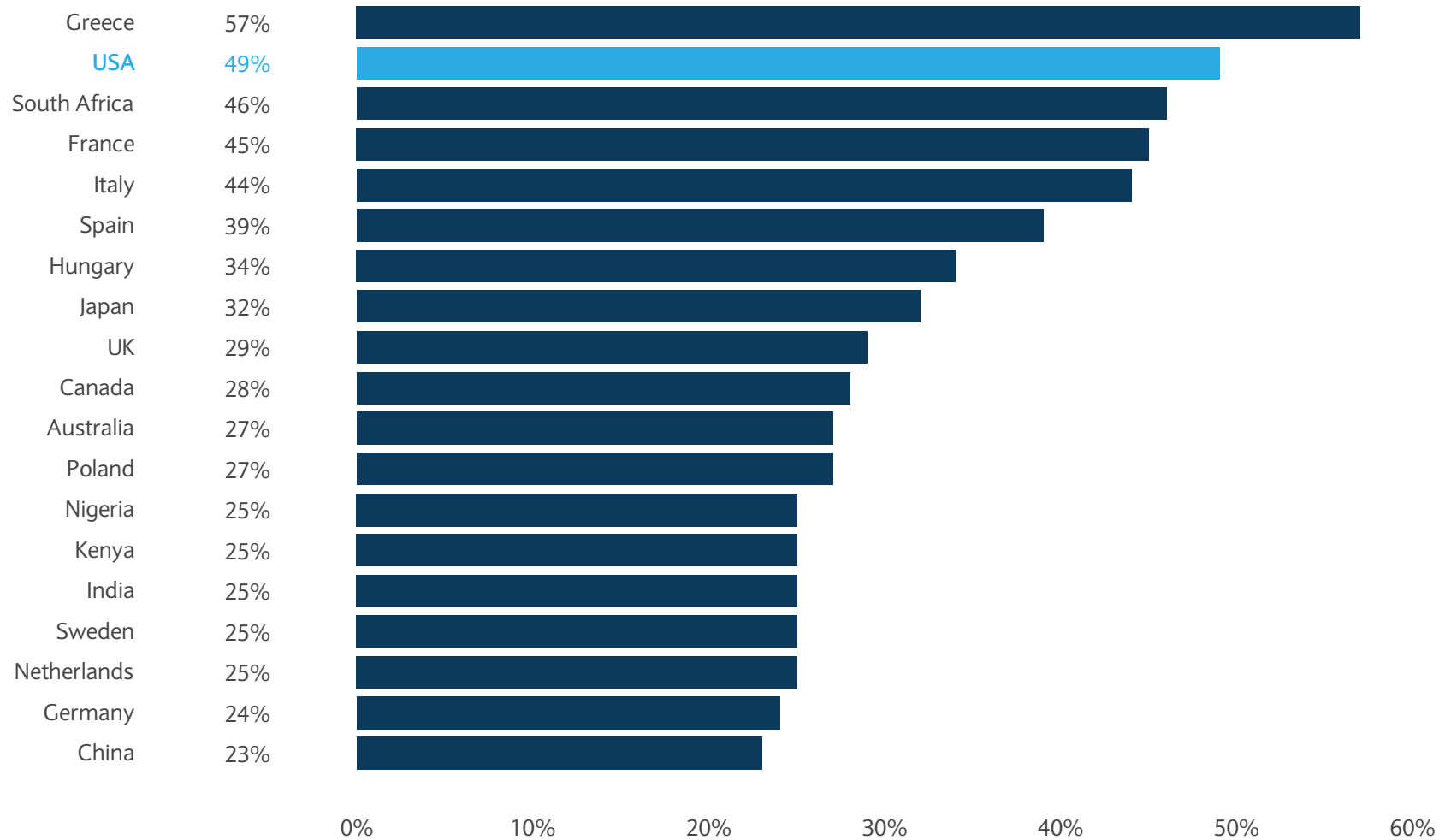


Source: Pew Research, Barclays Research

# Americans are especially skeptical about trade's effect on jobs

Americans are more skeptical about trade than almost every other major country

% agreeing that their country's involvement in the global economy is "a bad thing because it lowers wages and costs jobs"



Source: Pew Research, Barclays Research

9 out of 10 Americans want  
the government to  
encourage US companies to  
bring jobs back home

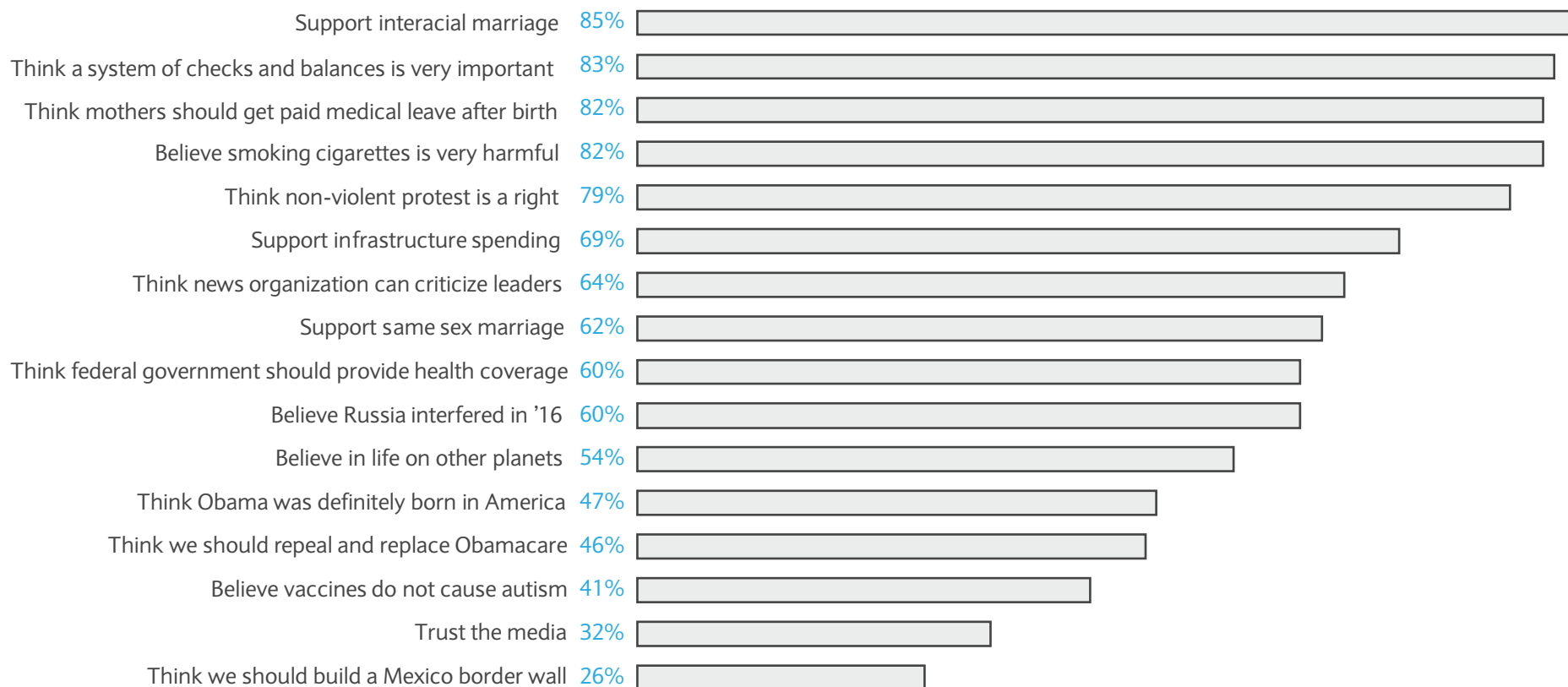
# More than anything else, in fact

Almost 9 out of 10 Americans agree: the government should do something to bring jobs back to the US

The federal government should create policies to encourage companies to bring jobs back to the US <sup>L</sup> 89%



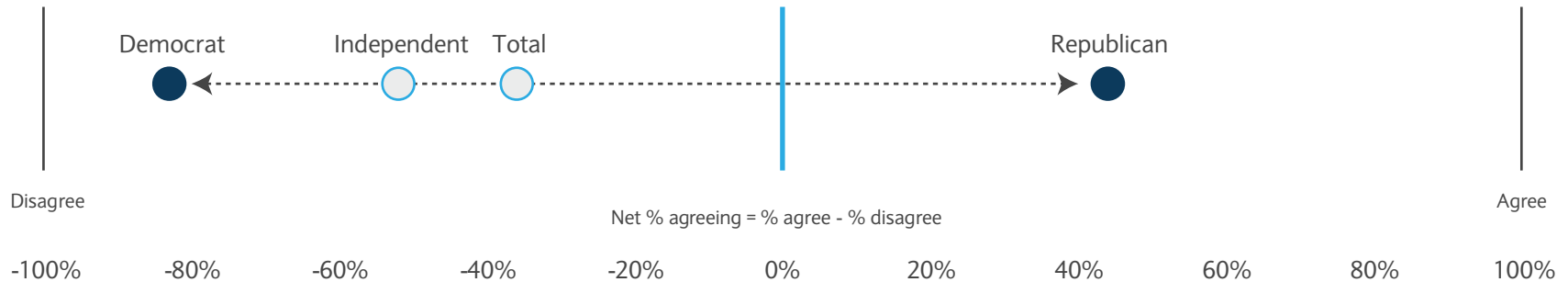
Keep in mind - Americans agree on almost nothing with this degree of unanimity. Here is the % of Americans who:



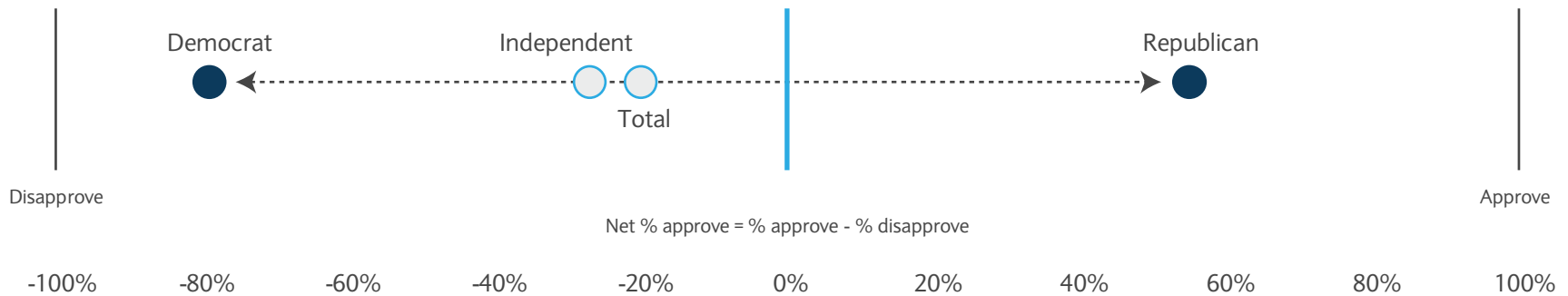
Source: Pew Research, Barclays Research

# This is where the agreement ends

As you know, President Trump has said that a trade war would be good for the United States, and could be easily won. Do you agree or disagree with this statement?



Do you approve of the way Donald Trump is handling trade?

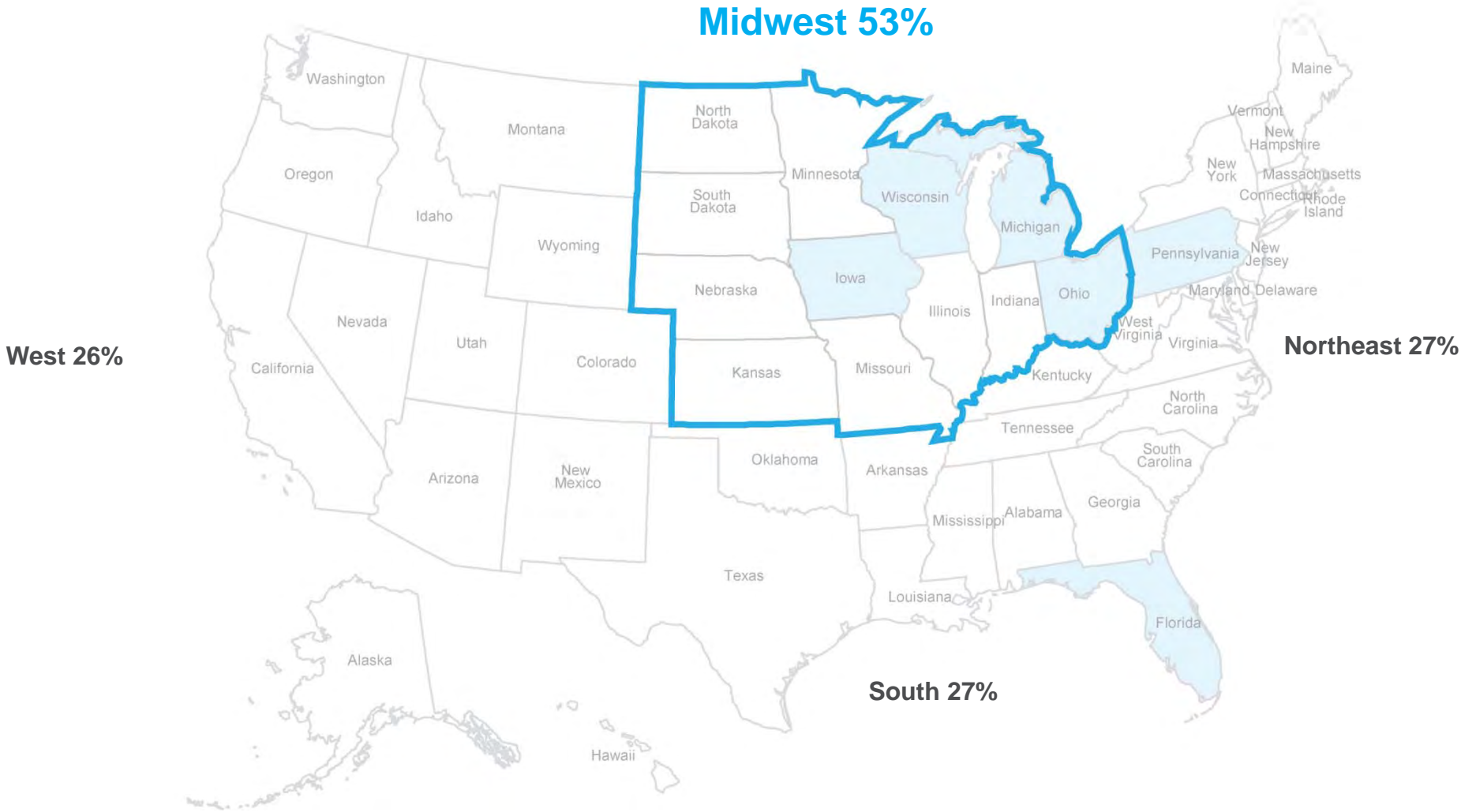


▶ Both of these results are relatively unchanged between these results from Mar 2018, and the first run of this poll in May 2017

Source: Pew Research, Barclays Research



# You don't need to please everyone, just the people that matter



Source: Pew Research, Barclays Research

# What's driving US tariffs on China?

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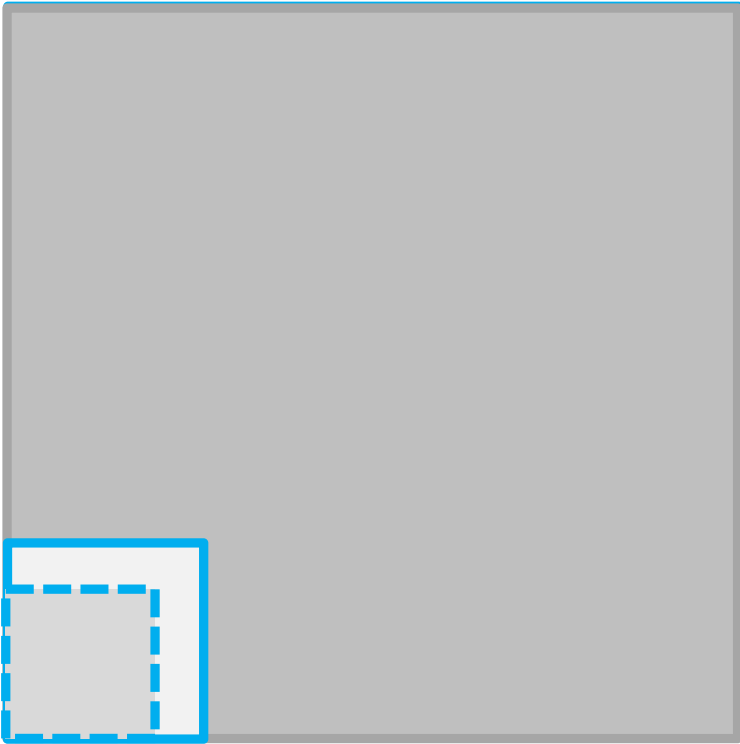
Three key issues

1. The trade deficit
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# Economic impact

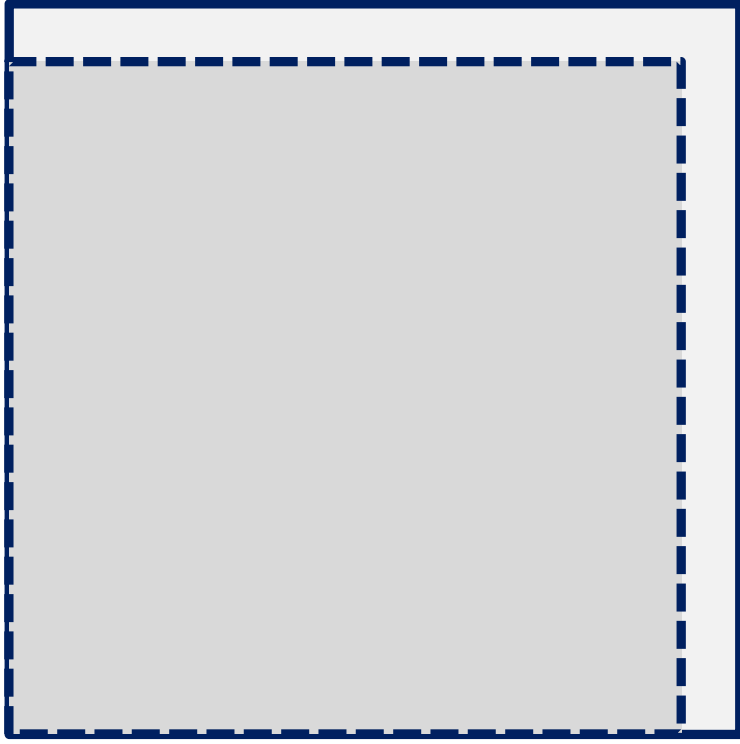
Big trade impact, small economic impact

US Trade with World



-25%

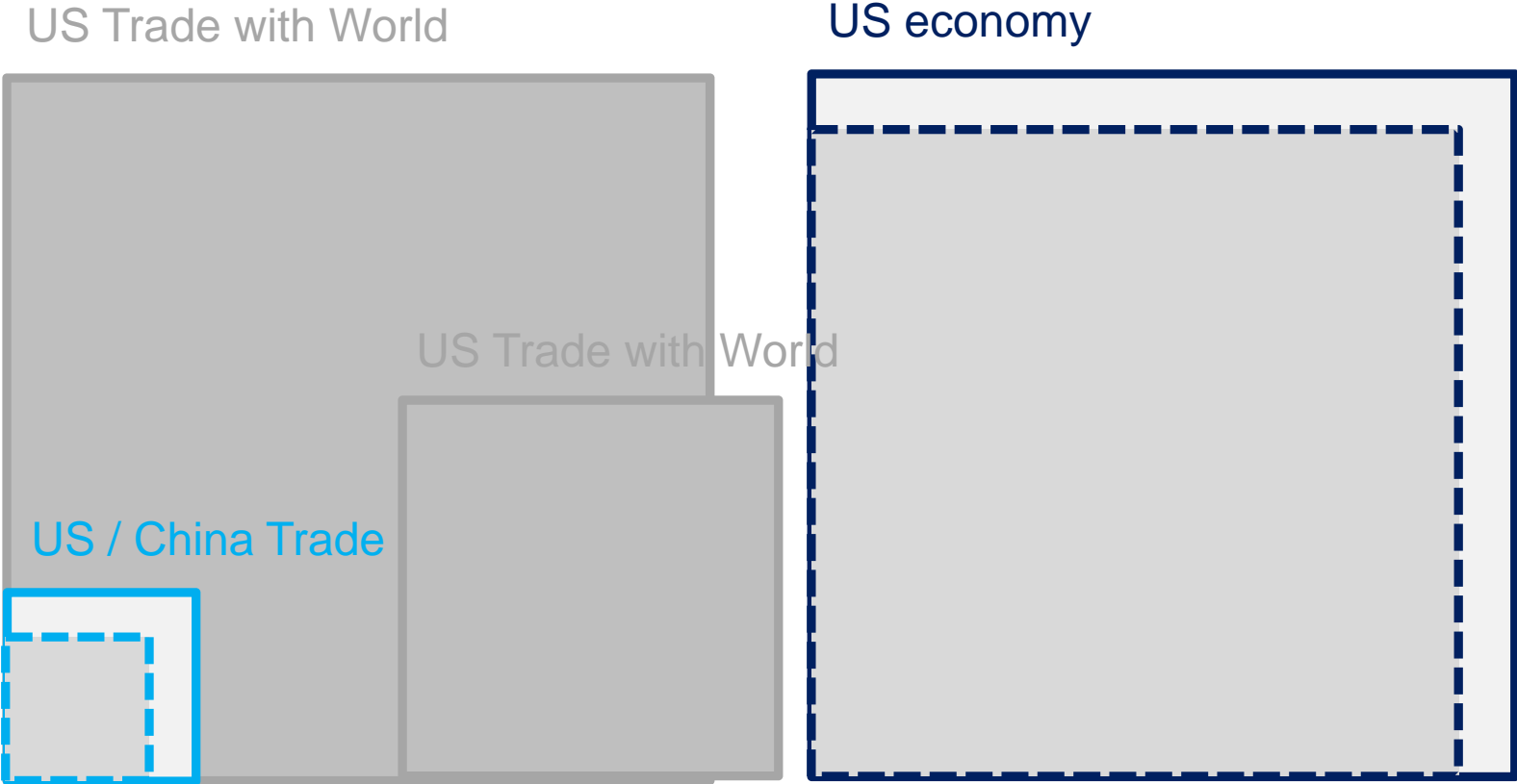
US economy



-0.2%

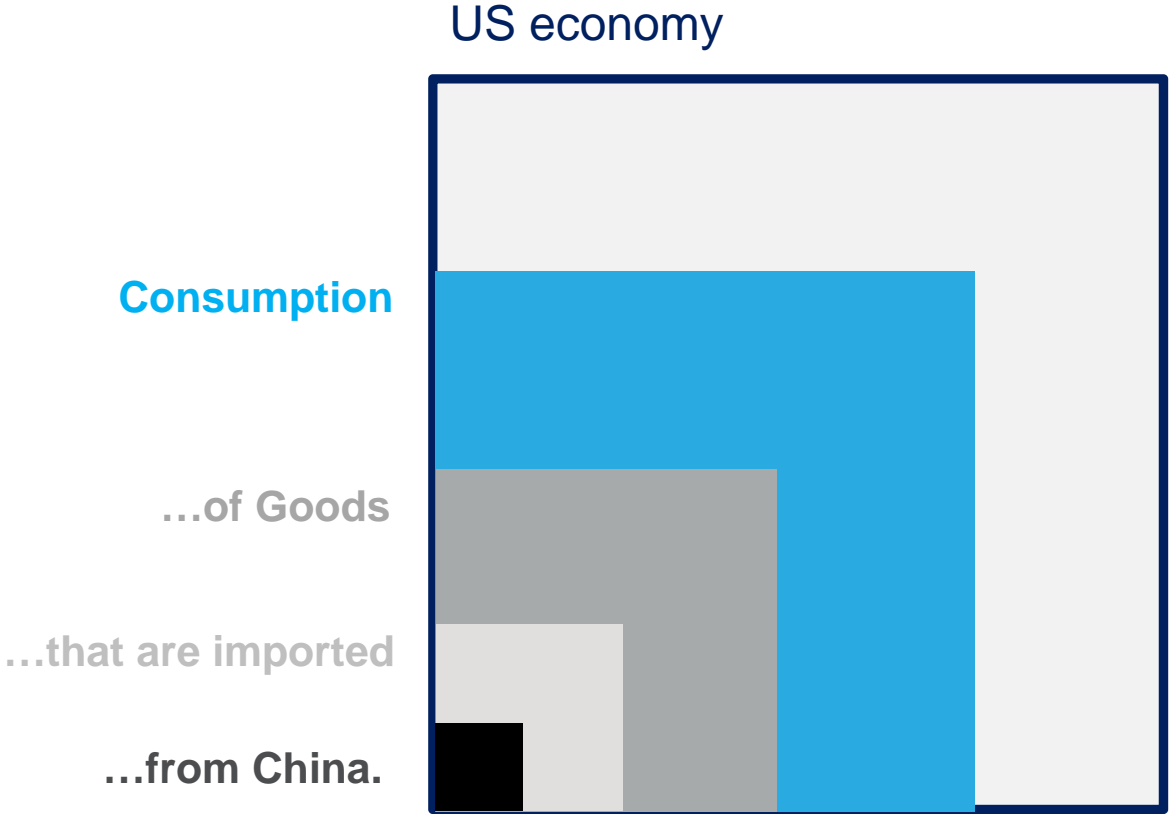
# Economic impact

Big trade impact, small economic impact



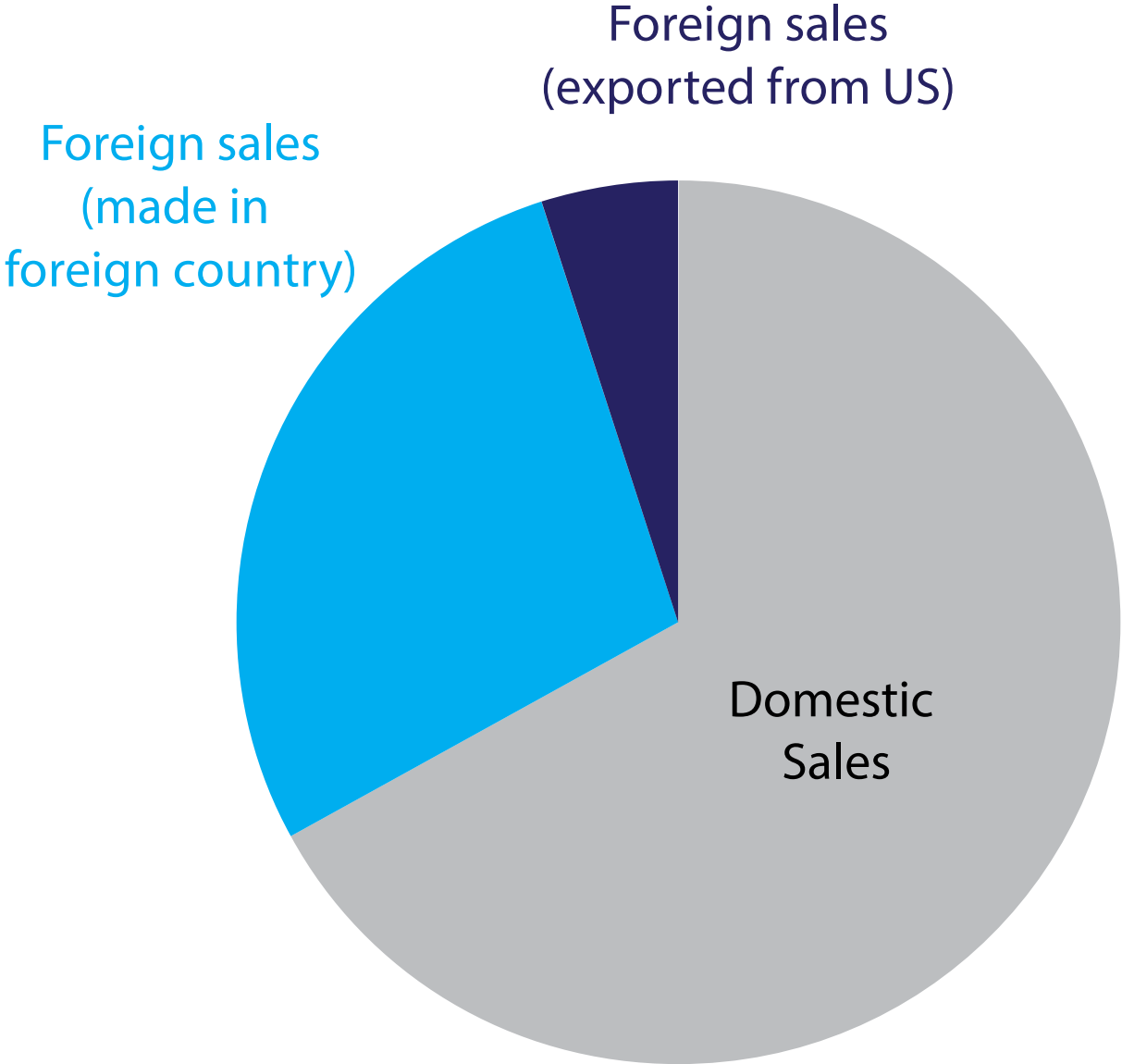
# Economic impact

## Small inflation effect



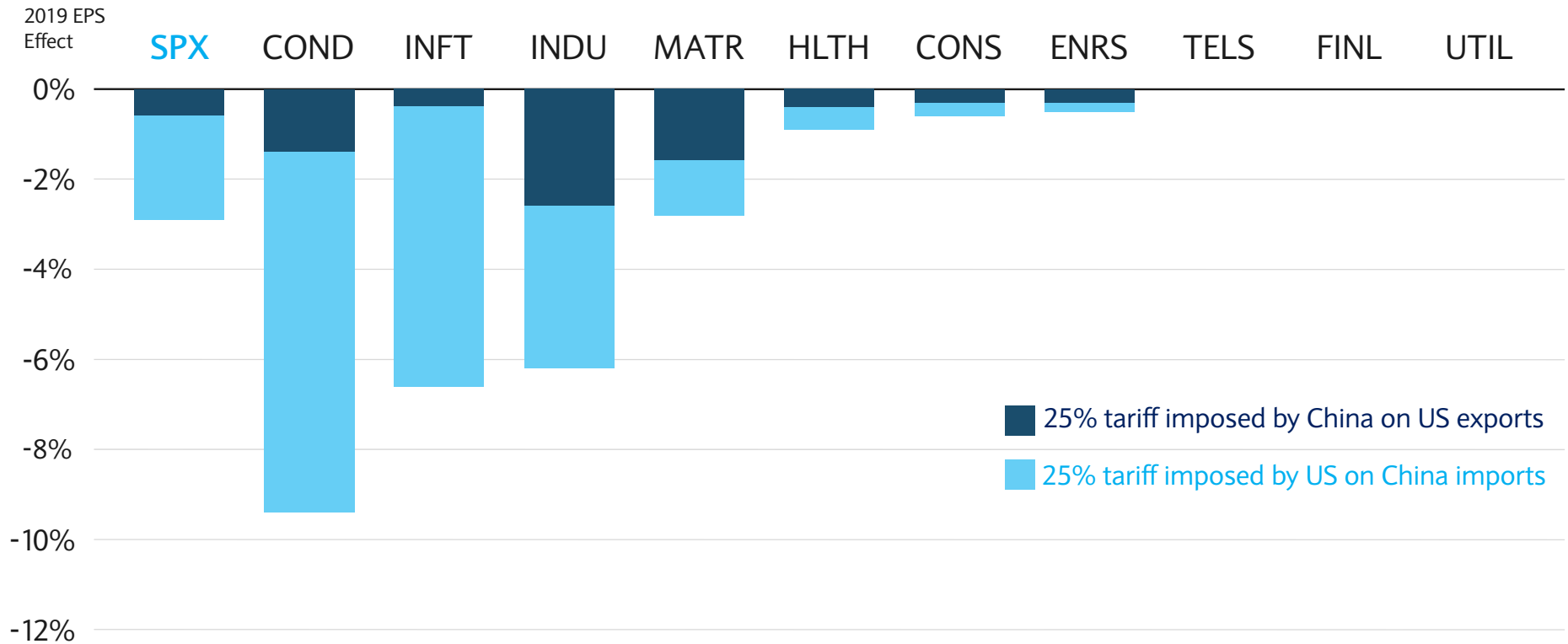
# Effect on companies

Most foreign sales not subject to tariffs



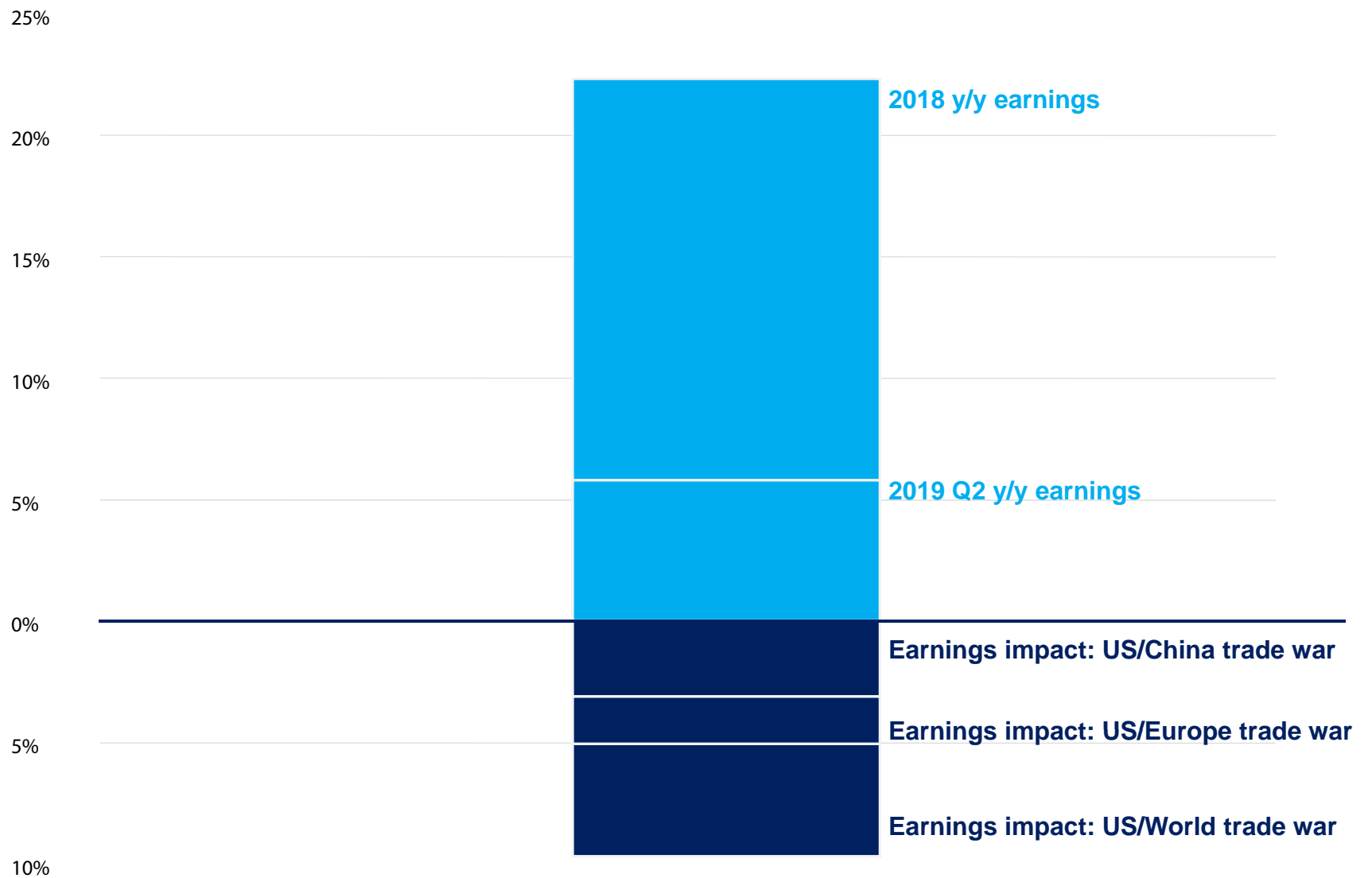
# Sectoral impact

Consumers, Infotech, and Industrials most at risk



# Some context

Earnings are strong and tariffs are small...for now





# Conclusion

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- A trade war is the biggest threat to the economy
- The motivations – the deficit, unfair trade, politics - suggest it will continue if not intensify
- In our base case, the economic impact should be pretty small
- This doesn't preclude a large impact on some companies within specific sectors
- The risk is that the trade war expands beyond China
- Or that the effect is magnified by slowing earnings

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