China-US Trade Conflict: Causes and Impact

Ha Jiming
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I. Background of China-US trade conflict

1. Comparison of real GDP growth between China and the US in different periods

2. Contribution of China and the US to world economy in different periods

1. Since 1950s, the US economic growth has been slowing down, while China’s economic growth has been continuously increasing. According to World Bank, China’s economy could surpass the US in terms of total volume becoming the largest economy in the world in 2031, if the average economic growth of the US remained at 2% and China at 6% since 2018.

I. Background of China-US trade conflict (continued)

   - The government controls fundamental economic factors like land and other resources either directly or indirectly, and state-owned enterprises have control over many economic resources through administrative monopoly.
   - Pricing mechanism is still limited in many sectors.
   - Effectiveness of protection on private property rights is still insufficient.
   - The government is taking various industrial policies as measures to realize diversified goals such as technology upgrade.

3. China promoted the “Made in China 2025” program.


5. Heightening contradiction among different social classes in the US
   The Gini Coefficient of the US has risen from around 0.4 in 1970s to the current around 0.48, indicating a widening gap between the rich and the poor. The falling of the Rust Belt has triggered anxiety among local residents, while American mainstream media attributed the reason for the falling of Rust Belt to globalization and foreign competition, which has speeded up America’s foreign policy shift.

6. The moderate politicians (Cohn, Tillerson) resigned, while Hawkish politicians (Navarro, Lighthizer, Kudlow, Pompeo, Bolton) were appreciated.

7. Creating trade conflicts with China could benefit the Republican in mid-term election.

II. Main Causes of China-US Trade Imbalance

1. Percentage of China’s current account surplus in GDP declined until 2017

- China’s current account has remained roughly balanced, with its balance occupying 9.9% of GDP at peak in 2007, and declining to 1.4% in 2017.
- The US trade deficit with China is still high, and 46% of total US deficit was with China in 2017, while 44.3% of total deficit was with the rest seven countries.

Source: Wind
II. Main Causes of China-US Trade Imbalance

- Following the collapse of the Bretton Woods system, the US trade deficit began to rise

1. US trade deficit-to-GDP ratio and gold prices

- US trade in goods has registered a continuous deficit since 1975. Under the Bretton Woods system, the dollar was convertible into gold; in this context, US deficit in foreign trade led to monetary contraction and then lower demand. In turn, this suppressed imports and promoted exports. As a result, a self-correcting mechanism was formed and the trade deficit shrank. However, since the US dollar was decoupled from gold in 1971, the US has been able to pursue its monetary policy freely, and the above-mentioned self-correcting mechanism has disappeared.

- Dollars earned in trade surplus countries are then channeled back to the US and support American purchases of foreign goods.
II. Major causes of the China–US trade imbalance
—Upgrade of “world factory” export

1. China’s deficit with other countries until 2017
2. China’s share in US trade deficit in goods

- While China has surplus with Europe Union and the US, it has deficit with other countries, which can show the pattern of global industrial chain. China imports intermediate products and export final products, and the data over estimated China’s surplus with EU and the US.
- Considering the high percentage of processing trade in China’s total trade, China’s trade surplus amounts to one third, which is still very high. China-US trade deficit measured by traditional/ value-added method has risen up from around 40% in 2000 to today’s 70%, indicating an upgrade of China’s export.
- Currently, US trade deficit with China is still high, but the added-value in China’s export is increasing gradually, which shows improvement of China’s industrial chain and industrialization, and great achievement that has been made during the process of transformation and upgrading of China’s industrial structure.

Source: OECD, Goldman Sachs, Wind
II. Major causes of the China–US trade imbalance
—difference in savings rates

1. Average national savings rates and trade balance to GDP ratios (2007–2016)

2. Share of China's working population and China’s savings rates

● Savings rate is an important factor to a country’s trade balance.
   - International comparisons suggest that a country’s savings rate is highly correlated with its foreign trade balance. Countries with high savings rates usually have a trade surplus.
   - Savings rate is also high correlated with labor population. China’s labor population reached peak in 2010, then decreased, and the savings rate also declined following that.

Source: World Bank, IMF, Wind
III. Impact on the Chinese economy

1. US imports from China, by product

<table>
<thead>
<tr>
<th>Product</th>
<th>Import (US$1 bn)</th>
<th>Share in China’s total exports to the US (%)</th>
<th>Share in the US total imports of the same product (%)</th>
<th>Share in China’s total exports of the same product (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cellphone</td>
<td>47</td>
<td>11</td>
<td>59</td>
<td>19</td>
</tr>
<tr>
<td>Furniture</td>
<td>30</td>
<td>7</td>
<td>52</td>
<td>33</td>
</tr>
<tr>
<td>Toy product</td>
<td>19</td>
<td>4</td>
<td>80</td>
<td>34</td>
</tr>
<tr>
<td>Knitwear</td>
<td>16</td>
<td>4</td>
<td>33</td>
<td>22</td>
</tr>
<tr>
<td>Plastic product</td>
<td>16</td>
<td>4</td>
<td>32</td>
<td>22</td>
</tr>
<tr>
<td>Automobile</td>
<td>15</td>
<td>4</td>
<td>5</td>
<td>22</td>
</tr>
<tr>
<td>Non-knitwear</td>
<td>14</td>
<td>3</td>
<td>36</td>
<td>19</td>
</tr>
<tr>
<td>Footgear</td>
<td>12</td>
<td>3</td>
<td>56</td>
<td>25</td>
</tr>
<tr>
<td>Monitor &amp; projector</td>
<td>10</td>
<td>2</td>
<td>48</td>
<td>22</td>
</tr>
<tr>
<td>Steel product</td>
<td>10</td>
<td>2</td>
<td>32</td>
<td>22</td>
</tr>
<tr>
<td>Optical machine</td>
<td>10</td>
<td>2</td>
<td>14</td>
<td>22</td>
</tr>
<tr>
<td>Organic chemicals</td>
<td>8</td>
<td>2</td>
<td>17</td>
<td>15</td>
</tr>
<tr>
<td>Electronic heating equipment</td>
<td>6</td>
<td>2</td>
<td>66</td>
<td>28</td>
</tr>
<tr>
<td>Motor device</td>
<td>5</td>
<td>1</td>
<td>42</td>
<td>25</td>
</tr>
</tbody>
</table>

- Industrial impact: The US announcement of 25% tariff on products worth US$50 billion on March 22 would largely affect industries linked to the “Made in China 2025” strategy in mid- and-long run. An additional tariffs on products worth US $100 billion could have impact on consumer goods and labor-intensive industries.

Source: UN Comtrade
III. Impact on the Chinese economy (continued)

We can assess the impact on China’s economy through hypothetic scenarios:

● **In a normal scenario, it would cost a 0.1 percentage point of China’s GDP growth in the short term.** The US imposes 25% and 10% tariffs on imports of China’s steel and aluminum, respectively, and executes the 301 investigation against China, which is to impose 25% tariffs on Chinese products worth US $ 50 billion.

● **In the worst scenario, This is likely to cost a 0.8 percentage point of China’s GDP growth rate.** Mutual sanctions between China and the US could result in a US$100 billion reduction in China’s trade surplus with the US.

● **In the superior scenario, expanding imports and opening the service will boost China’s consumption and effectively reduce China’s trade surplus with the US.**

Source: Public files
### III. Impact on the Chinese economy (continued) —expanding imports to meet consumption demand

#### 1. Percentage of household consumption in GDP of major countries

<table>
<thead>
<tr>
<th>Country</th>
<th>2016 Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>48%</td>
</tr>
<tr>
<td>Japan</td>
<td>56%</td>
</tr>
<tr>
<td>South Korea</td>
<td>54%</td>
</tr>
<tr>
<td>Russia</td>
<td>53%</td>
</tr>
<tr>
<td>India</td>
<td>59%</td>
</tr>
<tr>
<td>UK</td>
<td>63%</td>
</tr>
<tr>
<td>Brazil</td>
<td>69%</td>
</tr>
</tbody>
</table>

#### 2. Percentage of imports of consumer goods in GDP and household consumption

- **Import of consumer goods/GDP**
  - China: 6% (2016: 3%)
  - The US: 5.3%
  - Malaysia: 5.3%
- **Import of consumer goods/consumption**
  - China: 3.1%
  - The US: 4.4%
  - Malaysia: 9.5%

#### 3. Outbound tourist expenditure of China and other countries

- **Shopping**
  - China: 25%
  - Other countries: 29%
- **Accommodation**
  - China: 15%
  - Other countries: 19%
- **Dining**
  - China: 16%
  - Other countries: 18%

- **Chinese household consumption** accounted for 39% of GDP in 2016, much lower than in other major economies.
- China’s imports of consumption goods was 3.2% of household consumption or 1.3% of GDP, far lower than countries like the US and Malaysia, due to high tariff rates and distribution costs.
- Chinese consumers crave for foreign goods, as evidenced by strong shopping capacities of Chinese tourists.

**Source:** Wind, 2017 Outbound Chinese Tourism And Consumption Trends
III. Impact on the Chinese economy (continued)  
—High-tech imports and FDI

A regression analysis of factors behind China’s GDP growth:

\[ Y_t = 0.020 + 0.062X_1 + 0.045X_2 + 0.024X_3 - 0.038X_4 + 0.834Y_{t-1} \]

\[ t = (1.594) \quad (2.618) \quad (4.183) \quad (0.974) \quad (-0.996) \quad (17.679) \]

\[ Adjust \, R^2 = 0.893 \quad Sample = 63 \]

(1) \( Y_t \) stands for GDP growth in period \( t \), \( Y_t = \ln GDP_t - \ln GDP_{t-4} \);
(2) \( X_1 \) stands for growth of high tech product imports in period \( t \), \( X_1 = \ln IMPORT_t - \ln IMPORT_{t-4} \);
(3) \( X_2 \) stands for growth of investment on infrastructure in period \( t \), \( X_2 = \ln FC_t - \ln FC_{t-4} \);
(4) \( X_3 \) stands for growth of investment on infrastructure in period \( t \), \( X_3 = \ln I_t - \ln I_{t-4} \);
(5) \( X_4 \) stands for industrial value-added of state-owned enterprises/total industrial value-added.

As the above data is seasonal, we use data of period \( t \) contracted by data of period \( t-4 \) to calculate year-on-year growth.

From the regression analysis, we can see that import of high-tech product has significant influence on China’s economic growth. One percentage point increase of high-tech product import can increase GDP growth by 0.062% in short term and by 0.494% in the long run. One percentage point increase of actual use of foreign capital can increase GDP growth by 0.045% in short term, and by 0.392% in the long run.
IV. Impact on the US economy

1. China’s imports from the US, by product

- Among China’s imports from the US, machinery, aircraft, automobile, and soybean are the largest items.

- China might increase agricultural and energy imports from the US.

- China’s approach of “self-promotion of imports” contrasts 1980s Japan’s “self-restraint of exports”.

Source: UN Comtrade
IV. Impact on the US economy — increase inflation rate

1. The US inflation rate and expected data

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<table>
<thead>
<tr>
<th>Year</th>
<th>Annual PCE expected by Federal Reserve</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>1.5</td>
</tr>
<tr>
<td>2018</td>
<td>1.9</td>
</tr>
<tr>
<td>2019</td>
<td>2.0</td>
</tr>
<tr>
<td>2020</td>
<td>2.0</td>
</tr>
</tbody>
</table>
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Source: Wind

- **Increase inflation rate**
  - Robust economic and employment growths have already pushed up inflation and core PCE has been going up since the later half of 2017. The Fed has expected the core PCEs for 2018 and 2019 would reach 1.9 and 2.0 respectively. Meanwhile, improvement of employment on the US job market has begun to push up wages, and the tariff can further increase inflation.
IV. Impact on the US capital market and economic growth

1. The current bull market is the second longest after WWII

The MSCI US index shows that about 70 US listed companies—with a combined market value taking up 9.2%—of the index, generate more than 10% of their total revenue from the Chinese market. In contrast, the MSCI China Index shows that around 30 companies generate more than 10% of their revenue from the US market, with a total market value of only 2% of the index.

A survey of household financial assets in China and the US shows that the share of equity assets to total household assets in the US is much higher than in China.


2. Comparison of household asset structure in China and the US

<table>
<thead>
<tr>
<th></th>
<th>China</th>
<th>The US</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Composition of household assets (%, sum=100%)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-financial assets</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Real estate</td>
<td>54</td>
<td>24</td>
</tr>
<tr>
<td>Financial assets</td>
<td>41</td>
<td>71</td>
</tr>
<tr>
<td><strong>Composition of household financial assets (%, sum=100%)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and savings</td>
<td>75.7</td>
<td>14.4</td>
</tr>
<tr>
<td>Stock shares</td>
<td>15.5</td>
<td>21.7</td>
</tr>
<tr>
<td>Wealth management products of banks and funds</td>
<td>6.5</td>
<td>10.2</td>
</tr>
<tr>
<td>Insurances</td>
<td>-</td>
<td>28.9</td>
</tr>
<tr>
<td>Others</td>
<td>2.3</td>
<td>24.8</td>
</tr>
</tbody>
</table>

Impact on stock market and household fortune

- If a trade war were ignited, high inflation rate would force the Fed to increase interest rate, which would frustrate the stock price and housing price. The US stock and commercial real estate market have increased by 4 times and 87% respectively since 2009, the bull market period is the second longest one since the Second World War (slightly lower than the IT boom period in 2000), and the stock valuation is higher than other 90% periods in American history. Impact of increase in interest rate on enterprises investment cost and solvency, and the impact of price increase and asset price fluctuation on household consumption can constraint economic growth and even put the US economy back into recession after 9 years’ growth.

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Summary

• The China-US trade dispute is a long-term issue, and perhaps an epitome and harbinger of a broader changing bilateral relationship.

• However, there is still huge potential for trade and investment cooperation, considering the strong complementarity of the two economies.

• The two countries have responsibility to maintain the stability of global trade system, and should solve trade conflict through multilateral mechanism. No one wins a trade war.