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CORONA VIRUS THREATENS GLOBAL RECOVERY

On January 15, 2020 the US and China signed the first economic and trade agreement by signaling the intent to end the economic and trade hostility that has marred the bilateral relationship for over two years. The trade agreement signed on January 15 is broadly divided into seven parts and covers a wide range of agreements and roadmaps on protection of intellectual property (IPR), transfer of technology on market-based principles and trade. It is agreed that over 2017 baseline, China will import $200 billion of goods and financial services for the first two years. At the highest level, the agreement brings some clarity on US-China side of US-China-India triangle. For the global economy the growth expectations improve but marginally. The upside is limited as trade disputes are just one of the many structural problems.

The above comparative static of the Sino-US trade deal will be incomplete unless the impact of novel corona virus is factored into our analysis as events were coterminous. The new virus is of same genre as SARS virus of 2003. Although the fatality is low, the new virus has progressed at a much faster pace than 2003 SARS case. The impact of outbreak on China will be severe as Wuhan is the hub of transport and industry for central China. The total cost of SARS outbreak in 2003 at current prices is around $57 billion. Epidemiology models suggest the current disease is in ascending phase.

What will be the impact on US dollar and US interest rates? The deal envisages reducing the Sino-US trade deficit by 48% for its level in 2018 and hence one can expect that if the deal proceeds as planned USD will appreciate over time. The direction of interest rates will be conditional on three vectors – the US fiscal deficit, the progressive decline in FX reserve accretion of China and other factors such as inflation. Of late the interbank liquidity in the US was in deficit. Thus, all factors indicate marginal rise in bond yields in the US. However, on the other side , with global food prices at 71 month high and trend likely to continue central banks in emerging economies could make a unsynchronized exit from easy monetary policy . This could mean a weakening US dollar. In balance, we expect pressure on US dollar with risks tilted towards the downside as now.

For India, the mood swing in financial markets on account of aggressive posturing by the either side will become less. Thus, some order is expected in the global FX markets and Indian rupee will have an appreciating bias.

- On January 15, 2020 the United States (US) and China signed the first economic and trade agreement there by signaling and intent to end of economic and trade hostility that has marred the bilateral relationship for over two years.
- The trade agreement signed on January 15 is broadly divided into seven parts and covers a wide range of agreements and roadmaps on how the bilateral relationship will be taken forward mutually benefiting both the economies and not to mention the global economy.
- The Phase I agreement broadly covers agreements on sorting out differences on protection and treatment of intellectual property (IPR), transfer of technology on market-based principles. Trade in goods and (financial) services is a major part of agreement wherein China has committed to import roughly $200 billion of US goods. It has been also agreed that more transparency will be brought into foreign exchange (FX) operation undertaken by Central Bank in China in line with disclosures required by IMF. The US has already removed China from its list of currency manipulators two days prior to signing of the agreement.

TOPICWISE ANAYSIS

- **IPR:** A major thrust of the agreement is on protection of IPR of both sides. This understanding is done with an eye on thriving potential of digital technology in both the countries. The agreement covers protection of IPR in goods such as medicines, trade secrets, copyrights etc. The understanding includes timely identification and destruction of counterfeit goods including medicines sold on digital platforms or otherwise. The agreements talk about civil and criminal penalty on IPR infringements on both sides.
- **Trade agreements:** The lopsided trade balance between China and the US was initial point of disagreement and the trade agreement signals two-year road map to correct this imbalance. It is agreed that over 2017 baseline, China will import $200 billion of goods and financial services for the first two years. It is further agreed that this arrangement will continue till 2025, the quantum of purchases will be agreed on mutual basis in future.
- The trade in goods cover mostly three items – manufacturing, agriculture and energy. Manufacturing and energy are the two largest items. [See table]
- Trade in services mostly include financial services. With an eye on large domestic financial market in China, the agreement has sought market access for US financial services providers. The notable areas include permission to US credit rating agencies to operate in China and rate domestic bond issuances, access to US stressed asset funds in light of anticipated rise in delinquency rates in China in 2020. There is agreement on market access to US payment services provider into Chinese markets. With rising share of aged population in China it is also agreed that China will relax its FDI in insurance and pension funds by April 1, 2020 allow wholly U.S.-owned insurance companies to participate in these sectors.
- **Macroeconomic policy:** The (perceived) artificial level of USD-RMB parity had been an important area of contention between the two parties. RMB is on a managed float since 2005 and there are simultaneous efforts to internationalization RMB.

Product Category	Additional U.S. Exports to China on Top of 2017 Baseline		
	Year 1	Year 2	2-Year Total
Manufactured Goods	32.9	44.8	77.7
Agriculture	12.5	19.5	32.0
Energy	18.5	33.9	52.4
Services	12.8	25.1	37.9
TOTAL	76.7	123.3	200.0

Source: US-China Trade Agreement, 2020

- The agreement provides for avoiding manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage. A series of timely disclosures relating to FX reserves and forward positions have been agreed upon.

KEY TAKEAWAYS

- The agreement and the signals can be interpreted in various directions At the highest level, the agreement brings some clarity on US-China side of US-China-India triangle. This will have some second order implications for India and others who have trade ties with the US.
- An interesting aspect of the agreement is that the trade deal draws reference to WTO in respect of trade agreements. The two countries have agreed to settle any dispute bilaterally. There is a specific chapter devoted to this in the agreement. Thus, the agreement hints at alternate mutually agreed dispute resolution mechanism. The WTO's dispute resolution mechanism is nearing a grinding halt, the deal hints at new arrangement in the current geopolitical environment.
- The mutually agreed principles on disclosure in FX operations is good outcome given the vast trading footprint of China. This arrangement will benefit other trading partners of China as second order impact.
- A question arises as to what the impact of deal will be going forward. If the objectives and targets are met, the deal envisages reducing the Sino-US trade deficit by 48% for its level in 2018. This will definitely alter the Federal Reserve's calculations as both currency and labour markets in US will be impacted by this trade deal. On can expect that if the deal proceeds as planned the dollar will appreciate (quantum is difficult to estimate) over time. The direction of interest rates will be conditional on three vectors – the US fiscal deficit, the progressive decline in FX reserve accretion of China and other factors such as inflation. Of late the interbank liquidity in the US was in deficit. Thus, all factors indicate marginal rise in bond yields in the US.
- For the global economy the growth expectations improve but marginally. The upside is limited as trade disputes are just one of the many structural problems. Sector specific fragility such as in automobiles, debt, technology and energy transition are also contributing factor.
- For the emerging market economies, the mood swing in financial markets on account of aggressive posturing by the either side will become less. Thus, some order is expected in the FX markets and global trade will benefit due to stability in FX markets. The diversification of China's energy purchases towards the US will alters its geographical mix of energy imports. The share of the US is expected to rise in next two years.

IMPACT OF WUHAN NOVEL CORONA VIRUS (2019-nCOV)

- The above comparative static of the Sino-US trade deal will be incomplete unless the impact of novel corona virus is factored into the analysis as event were coterminous.
- The Pneumonia of unknown cause was first reported in WHO Disease outbreak news on January 5. By January 12 the outbreak was confirmed. The new virus is of same genre as SARS virus of 2003. A comparison of progress of both the virus is shown in table below.
- The studies on economic impact of SARS virus of 2003 suggest that the outbreak had impacted industries such as tourism and the retail service sector. The total cost of SARS outbreak in 2003 was $40 billion which at current prices is around $57 billion.
- Although the fatality is low, the new virus has progressed much f aster than 2003 SARS case. The impact of outbreak on China will be severe as Wuhan is the hub of transport and industry for central China. With sudden shift in expenditure priority growth will be affected in China and globally. Epidemiology models suggest disease is in ascending phase hence it is difficult to assess the full impact at this stage.

Comparison between 2003 SARS Corona Virus & Novel Corona Virus

	2003 SARS Corona Virus	2019 Novel Corona Virus
Number Affected	8,096.0	4,515.0
Fatality	774.0	106.0
No of Countries affected	29.0	16.0
Fatality rate	9.6	2.3
Total progression time	6 months	23 days
Total cost ($ Billion)	40.0	NA
Source: CDC, WHO		

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