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TRADE WAR: MORE SMOKE LESS FIRE

World trade has been slowing down over the past few years. The year 2017 ushered in better trade prospects, but just as global trade has started showing positive momentum, the issue of trade wars has surfaced again. This is however not the first instance when countries have been involved in trade kerfuffle. World history is riddled with instances of prolonged trade wars.

There are several interesting implication of such trade wars.

First, empirical evidence suggests that none of the trade wars which started bilaterally turn into a full fledged multilateral trade wars, though the trade wars were prolonged for close to a decade in some cases.

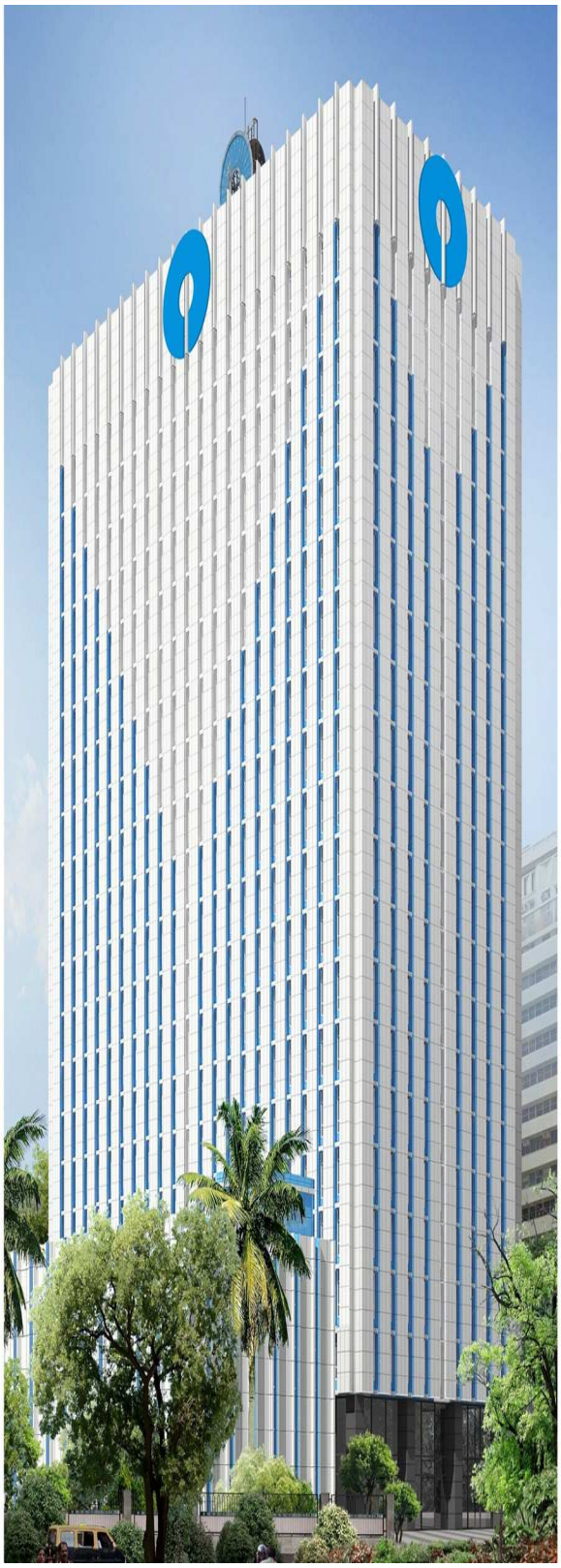
Second, such trade wars may not necessarily have any impact regarding financial stability, though some volatility was observed during the past periods of trade disputes, however the markets eventually recovered in all cases of trade wars. In fact, during 1993-2001 prolonged trade dispute between US and EU, the US markets kept on rising. The recent imposition of steel and aluminium tariffs has increased S&P 500 volatility. However, market has factored in the news and is stabilising. The dollar has also now started appreciating against the basket of 6 major currencies now that fears of full-fledged trade war between the US and China have dissipated.

During the last period of trade dispute 1993-2001, current account deficit of US increased significantly to 3.7% of GDP in 2001 from 0.9% of GDP in 1993. However, the US dollar appreciated against the Euro during this period.

The moot point is therefore the US $ will keep on appreciating even though US may be engaged in trade wars. This will have an impact on capital flows to emerging economies. The recent depreciation in emerging economies currencies, including India bears testimony to this fact.

Additionally, besides resorting to tariffs, US is also resorting to non-tariff barriers. Over the years it can be seen that non-tariff measures have risen considerably. Such non-tariff barriers are more a manifestation of protectionist measures.

Moreover, the ongoing banter between the US and China has not affected Indian stock markets much. Interestingly, if the relationship between US and China leads to some reduction in US exports to China and India capitalises on it by even trying to capture 1% of the total Chinese imports from US, we can see an additional 10% increase in India's exports to China.



HISTORY OF TRADE WARS

- World trade has been slowing down over the past few years. Merchandise exports declined to $15.9 trillion in 2016 from around $18.3 trillion in 2011, while imports also registered a drop to $16.2 trillion from $18.5 trillion during the same period. Overall global merchandise trade witnessed a decline of 3.0% in 2016 compared to a double digit growth witnessed between 2003 and 2011 (2009 was the exception year). After 2011 trade growth fell significantly and even entered the negative territory from 2015. However, the year 2017 ushered in bettering trade prospects and the average growth has been 10% and 11% for exports and imports respectively. Just as global trade has started showing positive momentum, the issue of trade wars has surfaced again.
- This is not the first instance when countries have been involved in trade kerfuffle. World history is riddled with instances of prolonged trade wars. The table lists some of them.
- Historically, trade wars which started bilaterally have not turned into full fledged multilateral trade wars, though were prolonged.

History of Trade Wars

Countries	Time period	Commodity	Remarks
Italy Vs. France	1886-95	Multiple Commodities	Italy denounced its commercial treaty with France in 1886
France Vs. Switzerland	1892-95	Multiple Commodities	France denouced its treaty with Swtizerland
Russia Vs. Germany	1893-94	Multiple Commodities	High Russian tariffs inhibited German industrial exports and Russian agricutural products unfavorably treated in Germany
US Vs. Italy, Canada, Switzerland, France, Britain, Spain	1930-34	Multiple Commodities	US responded to agriculture price decline with Smoot hallew tariff which was followed by retaliation throughout Europe
US Vs. France, Germany	1962	Chicken, potato starch, dextrin, brandy and light trucks	France imposed tariff on US chicken and Germany, Europe joined. US retaliated increasinf tariffs on a number of products
US Vs. EU	1993-2001	Bananas	EU imposed tariffs on bananas from Latin America which were produced by US multinationals. US retaliated with tariffs on number of products

Source: SBI Research

LOOMING THREAT OF TRADE WAR

- Ever since Donald Trump took charge as the President of USA, he has taken a number of protectionist measures with coming out of TPP (Trans Pacific Partnership) being the major one. Renegotiation of NAFTA, increase in tariffs and stricter regulations for H1B visa are other such measures taken by the US which point towards increased protectionism.
- This year Trump announced levying import tariff on steel and aluminium at 25% and 10% respectively. The unilateral imposition of such sudden large magnitude of tariffs is against the WTO provisions. The rise in steel and aluminium tariffs might lead to some short term positive impact on steel industries but its negative impact on construction and manufacturing sectors, the major users of steel and aluminium cannot be ruled out. Moreover, the fear of trade war exists which will have serious implication for global growth. Historically also the US had imposed steel tariffs earlier in 2002. However, they were revoked the very next year as they led to job losses. From the recent steel and aluminium tariffs, Mexico and Canada were initially exempted and later temporary exemptions have also been extended to Korea, EU, Argentina, Australia and Brazil. But these exemptions lapsed on 1 May'18. While tariffs on Canada, Mexico and the EU have been held off, giving them a 30-day reprieve, US informed that agreements in principle have been reached with Argentina, Australia and Brazil and would be finalized shortly.

Timeline of US and China actions

22-Jan	Trump imposed steep tariffs on imported washing machines and solar panels	
8-Mar	Trump ordered stiff tariffs on imported steel and aluminum	
22-Mar	U.S. Trade Representative proposed 25% duties on Chinese products under section 301	
2-Apr		China imposed tariffs on 25% on 128 US imports including fresh fruits, nuts, wine and pork
3-Apr	The U.S. released a list of targets for proposed tariffs on $50 billion worth of imports	
4-Apr		China announced an additional 25% tariff on imports of 106 U.S. products
5-Apr	Trump instructed the USTR to consider $100 billion of additional tariffs	
6-Apr		China said it will use new comprehensive countermeasures to firmly defend its interest

Source: SBI Research

- The steel tariffs as such are not going to have a major impact on China as the country exports only 2% of the total US steel imports. So China didn't react immediately. However, following USTR's Section 301 investigation the United States imposed additional tariffs covering approximately 1,300 separate tariff lines amounting to around $50 billion of Chinese imports, China imposed retaliatory tariffs on 128 US imports worth $3 billion, including fruits and pork, thus increasing the fears of trade war.

- China vowed to impose measures of the "same strength" in response to a proposed US tariff hike. The discussions were held between China and US which led to some agreements between the two countries while differences still remain. The fears of full-fledged trade war between the two have now dissipated, though the US might continue to impose anti-dumping duties on Chinese goods.
- Amidst ongoing trade dispute between the US and China, the latter posted a current account deficit in Q1 2018, for the first time in nearly 17 years. The trade balance has also declined to $49 billion. In Mar'18 the country registered trade deficit, the first time in over a year (last deficit in Feb'17). During the quarter, the goods trade still ran a surplus, while the service trade posted a large deficit thereby contributing to current account deficit.

China BoP data ($ billion)					
	Current Account Balance	Trade Balance	Exports to US	Imports from US	Trade Balance with US
Q1 2017	16	66	88	38	50
Q2 2017	53	122	106	37	69
Q3 2017	34	117	117	38	80
Q4 2017	62	133	122	42	80
Q1 2018	-28	49	100	42	58

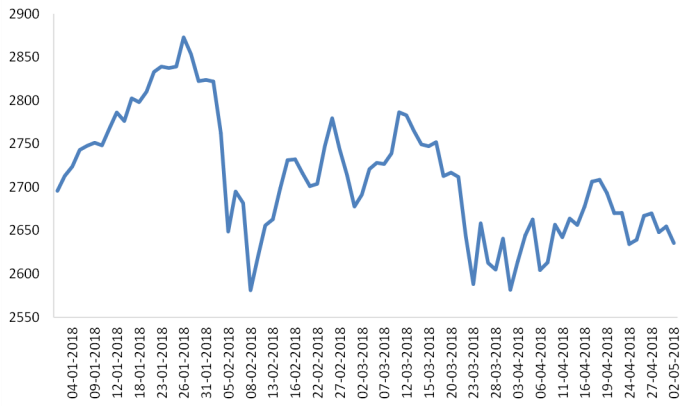
Source: SBI Research, General Administration of Customs, China, CEIC

- Regarding the bilateral trade with US, exports to the US declined by around 18% qoq in Q1 2018 while in yearly terms, they have increased 13.6%. The surplus with US is still higher in Q1 2018 compared to Q1 2017. Thus it seems that the deficit in current account has more to do with the structural transformation that China is undergoing. In fact, the current account surplus of China has been witnessing a gradual decline to 1.3% of GDP in 2017 from 9.1% of GDP in 2008.

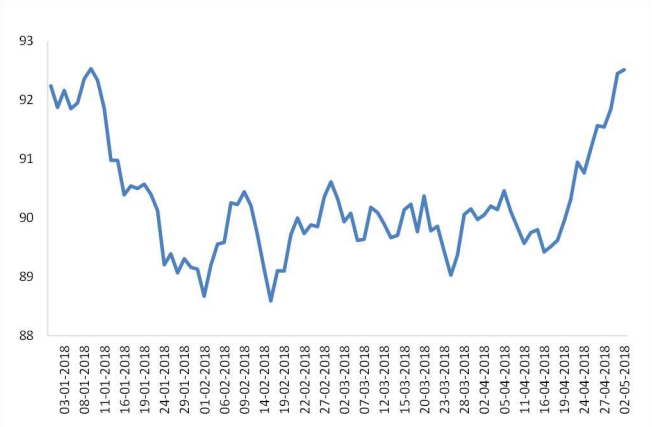
FINANCIAL VOLATILITY AND TRADE WARS

- During the Great Depression, US adopted protectionist measure of imposing Smoot-Hawley Tariff Act. The general slowdown was prolonged due to the tariffs. In 1934, President Franklin D. Roosevelt signed the Reciprocal Trade Agreements Act, reducing tariff levels and promoting trade liberalization and cooperation with Foreign Governments. During 1930-34 the S&P 500 declined by more than 50%. However, the markets eventually recovered in all the cases of trade wars. In fact during 1993-2001, notwithstanding prolonged trade dispute between US and EU, the US markets kept on rising.
- During the last period of trade dispute 1993-2001, current account deficit of US increased significantly to 3.69% of GDP in 2001 from 0.89% of GDP in 1993. The US trade deficit with EU increased to $64.6 billion by 2001 from $16.9 billion in 1997. Moreover, the US dollar appreciated against the Euro during this period.
- More recently, S&P 500 started declining after Trump's imposition of tariffs on washing machine and solar panels in Jan'18. In March again the imposition of tariffs increased S&P 500 volatility. However, the market has factored in the news and is stabilising.
- The dollar index has also been volatile this year but it started declining since the mid-January even before the tariffs were announced by Trump. However, it has started gaining against the set of six major currencies now that the discussions on trade wars have also lost steam.

Graph 1: S&P 500



Graph 2: Dollar Index (DXY)



Source: SBI Research, Bloomberg

IMPACT ON INDIA : CASE STUDY OF IRON AND STEEL INDUSTRY

- Of the total India's iron and steel exports in FY17, only around 11% went to the US (a reduction from 14.2% in FY13). Also, if we look at the total of India's exports to US, iron and steel accounted for only 1.9% in FY17 (reduction from 3.1% in FY13). Thus it seems that India's overall exports to the US have been on a declining trend over the years and thus India might not be impacted much directly from increase in import tariff in the US.
- However, if this leads to increase in tariff by other countries in retaliation then this would have an adverse impact on global economic growth, including India.

India's Exports of Iron and Steel ($ Million)					
	FY13	FY14	FY15	FY16	FY17
Export to US	2,210	1,911	2,413	1,638	1,594
India's export	15,526	16,031	16,276	11,649	14,599
Share of US in India's iron & steel exports	14.2	11.9	14.8	14.1	10.9
India's exports of all commodities to US	72,310	78,284	84,897	80,672	84,425
Share of iron & steel's exports in total exports to US	3.1	2.4	2.8	2.0	1.9

Source: Ministry of Commerce

- Also, another channel through which India could get hurt is if countries like China, who were earlier exporting to the US, start dumping their produce in India after facing higher tariffs in the US.

DOMESTIC STEEL INDUSTRY

- If the domestic production is looked at, India is increasingly producing more of both finished steel and crude steel. For FY17, exports of finished steel have increased while its imports have declined, implying we are becoming more self-sufficient. As per the latest data available in World Steel Association, India became net exporter of steel in 2016, importing 9.9 million tonnes and exporting 10.3 million tonnes. Various Government initiatives, including minimum import price and anti-dumping duty have provided support to the domestic steel industry. However, at the same time this has hampered the industries which use steel as an input. Thus, there is always a trade-off while giving protection to a particular industry.

Production of Finished Steel and Crude Steel (in million tonnes)							
Item	FY13	FY14	FY15	FY16	FY17	Apr-Dec FY18*	
Finished Steel							% yoy
Production	89.6	95.6	100.7	102.9	115.9	86.7	1.4
Imports	7.9	5.5	9.3	11.7	7.2	6.1	11
Exports	5.4	6.0	5.6	4.1	8.2	7.6	52.9
Consumption	73.5	74.1	77.0	81.5	84.0	64.9	5.2
Crude Steel							
Production	78.4	81.7	89.0	89.8	97.9	75.6	4.8

Source: Annual Report FY18, Ministry of steel, *Provisional

- Unlike global prices, Indian domestic steel prices have maintained their strength. Long product prices have been strong due to seasonality and are likely to remain firm in Q1FY19 too. Flat product prices are also likely to remain strong, supported by an improvement in the Automotive sector. But challenges will come from US import tariff once this would create higher availability in the domestic market, if the same results in higher competition in the exports markets for India.
- Aluminium price fell by 7% mom while Copper prices fell by around 2% mom. Significant decline in Aluminium prices can primarily be attributed to commodity trade advisors (CTAs) liquidating their positions due to concerns about escalating trade hostilities post the imposition of import tariff by USA. Also, high unsold inventory of Aluminium in China and expectations of higher production post the winter heating period added to the worry for CTAs, leading to position unwinding and consequently price correction.

INDIA CAN GAIN MARKET SHARE

- The ongoing banter between the US and China has not affected Indian stock markets much. On the days the involved parties have made announcements the markets have seen some slide, but they have recouped again.
- US had exported goods worth $130 billion to China in 2017. Meanwhile in FY17 India exported $10 billion worth to China. So obviously we cannot match US in scale. However, if the relationship between US and China leads to some reduction in US exports to China and India capitalises on it by even trying to capture 1% of the total Chinese imports from US, we can see an additional 10% increase in India's exports to China.

NON-TARIFF MEASURES

- Besides resorting to tariffs, the US is also resorting to non-tariff barriers as well. US has recently imposed anti-dumping duty on the stainless steel flanges imported from China and India on the ground that these countries provide subsidies to their exporters.

Non-Tariff Measures										
	Sanitary and Phyto-sanitary	Technical Barriers to Trade	Anti dumping	Counter vailing	Safeguards	Special Safeguards	Quantitative Restrictions	Tariff-rate quotas	State Trading Enterprises	Export Subsidies
31-Mar-10	8676	11973	1541	86	51	599	435	1268	247	429
31-Mar-11	9688	13253	1530	86	53	614	446	1268	247	429
31-Mar-12	10620	14554	1538	104	58	625	471	1270	247	429
31-Mar-13	11543	16147	1574	113	63	629	951	1274	247	429
31-Mar-14	12530	17759	1696	124	64	632	1029	1274	248	429
31-Mar-15	13751	19229	1696	141	68	633	1178	1274	261	429
31-Mar-16	14869	20735	1833	155	71	633	1190	1274	287	429
31-Mar-17	16989	24150	2034	184	55	633	1635	1274	287	429

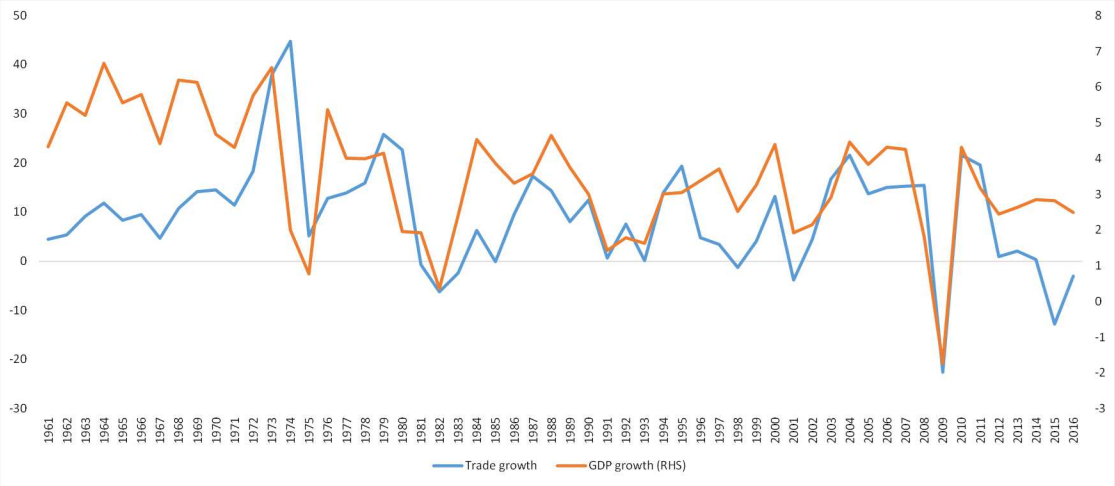
Source: WTO, SBI Research

- From 20 Jan'17, through 20 Mar'18, the Commerce Department has initiated 102 antidumping and countervailing duty investigations – a 96% increase from 20 Jan'16, through 20 Mar'17. Commerce department currently maintains 428 antidumping and countervailing duty orders which provide relief to American companies and industries impacted by unfair trade.
- Over the years it can be seen that non-tariff measures, especially sanitary and phytosanitary and technical barriers to trade have risen considerably. All the economies should reach a consensus so that the non-tariff barriers are not abused and world trade keeps flourishing.

CONCLUSION

- During the periods of trade dispute between France, Germany and the US in 1962, global trade continued to increase. However, trade as well as GDP growth declined in 1993 when banana war began between EU and US and the end of this tariff war did not result in improvement in global trade and growth dynamics. Thus a conclusion stating one-on-one relationship between trade wars and world GDP growth would be too simplistic. However, as global trade growth and global GDP growth mirror each other, it is given that trade growth has to be there in order fuel global GDP growth.
- The current dispute between the US and China provides opportunity for other players to expand their trade and keep the momentum going.

Graph 3: Trend in in global trade and global growth (%)



Source: SBI Research

ABOUT US

The Economic Research Department (ERD) in SBI Corporate Centre is the successor to the Economic and Statistical Research Department (E&SRD). The latter came into being in 1956, immediately after the State Bank of India was formed, with the objective of "tendering technical advice to the management on economic and financial problems in which the Bank has interest and which required expert analysis".

After the first reorganization of the Bank, when specialized departments like Management Science, Management Information Systems, Planning and Market Segment Departments took over the statistical work of E&SRD, the Department was renamed as ERD.

However, with the ERD team now taking on multidimensional functionalities in the area of risk management, corporate analytics, strategy and so on, who knows, the time may have come to rename it again!

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