

From G20: short-term relief, but it is not the final word on trade disputes



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- *The latest G20 demonstrates some **temporary progress** in the US/China relationship. An increase of tariff rates in January 2019 was put on hold and the possibility for an additional tranche of tariffs for the rest of US imports from China (\$267bn) is also further delayed, at least. China has found the right entry point to give some concessions to the US on sensitive topics for President Trump.*
- *This is **positive news for China**, who can buy time to refine the implementation of policy actions to face the economic slowdown and to push for more reforms and measures to open up the economy.*
- ***Our view:** we believe that neither this scenario nor the worst case of no agreement was completely priced in the market, even though markets partially discounted a weak scenario, with some risk of deterioration of China/US relationship and China's economic slowdown. This, combined with a more dovish Fed, could support a relief rally in the short term.*
- *Looking at the medium term, some uncertainties and risks remain. This deal does not end the trade disputes. The mix of agricultural, energy and industrial disputes still in place is very important for Trump's electorate and there is a risk that the trade war rhetoric will resurface during the next presidential campaign in the US, keeping market volatility high.*
- *In conclusion, we don't see the G20 deal as a game changer, rather as a short-term achievement that could bring some relief to the markets through the year end.*

1. What are the key takeaways on global trade from the latest G20 meeting?

US and China reached a temporary deal for now, after a "highly successful meeting" according to the White House.

More details will emerge in the coming days and weeks but, based on official reports from both sides, we view this deal as temporary, rather than the end of the trade war. At the same time, this is very meaningful for China and the world economy. Both sides are aware that to ultimately solve the ongoing disputes, more time will be required, as many complex issues are at stake. The G20 has made some progress in the US/China relationship. At least for now, there are higher hopes for US/China to find a solution. Not only was an increase in tariff rates in January 2019 paused but the risk of an additional tranche of tariffs on the rest of US imports from China (\$267bn) has also been delayed. Based on Chinese report by Xinhua, a top official media, there is a possibility that tariffs which have already been implemented could be removed. However, this is, in our view, very unlikely. If Trump seeks to maintain pressure on China, it is unlikely that already implemented tariffs would be abandoned during the negotiation period, unless China significantly increases its imports from the US.

2. What is the main impact on China?

For China, such a deal is perhaps already good news, as the country now needs more time to face the current economic slowdown and to restore weak investor sentiment. The latter deteriorated dramatically after President Trump announced aggressive policies since June. In the meantime, China has implemented several fiscal and monetary measures to deal with this deterioration, but it still needs time to adjust and improve their implementation. Given this time window, Chinese policy measures could be in a better position and more effective if overall sentiment and expectations improve. In addition, the strength of the US economy is expected to cool off in 2019 - at least marginally - and this could also help to reduce pressures, such as the US dollar strength on RMB, preventing Trump from being too aggressive. Buying time, for China, is also important because it leaves room for manoeuvre for Chinese authorities to push for more reforms and measures to open up the economy. Some reforms were planned but slowed down, and could now be revived, such as ongoing improvements in regulations on wealth management products and the openness of the financial system. In parallel, US

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pressure on China's economy has further increased the pressure to open up the economy and to improve efficiencies for State-Owned Enterprises.

China Official Purchasing Manager Indices (PMI)



Source: CEIC, Amundi Research, as of November 7, 2018.

3. What are the main achievements from a US perspective?

According to the White House statement, China made some concessions on sensitive topics for the US administration. China agreed to implement the more stringent policy on Fentanyl¹ exports to the US, where it is illegally used as a drug. China also agreed to purchase a yet to be defined but substantial amount of agricultural, energy, industrial, and other products from the US and to start purchasing agricultural products immediately. China could also approve the previously rejected Qualcomm-NXP deal, should it be presented again and continue to collaborate on the North Korea issue.

4. What could happen from now?

The US is expected to pause the tariff increase on 1st of January 2019 and the two sides would immediately begin negotiations on structural changes with respect to forced technology transfer, intellectual property protection, non-tariff barriers, cyber intrusions and cyber theft, services and agriculture. These are the hottest topics that remain as medium-term challenges. The timing of negotiations is within the next 90 days and we believe that this 90-day period might be extended once or twice, if negotiations make sufficient progress. If a final deal is not reached by the end of the defined period, the tariffs will be raised to 25%.

5. What could be the implications for financial markets?

We believe that neither this scenario nor the worst case of no agreement was completely priced in the market, even though markets partially discounted a weak scenario, with some risk of deterioration in the China/US relationship and a China economic slowdown. Hence, the agreement is good news in the short term and it could trigger a relief rally, also considering attractive valuations in Emerging Markets and China assets. A more dovish Fed could also support risk assets' recovery, in particular equities. Looking ahead, some uncertainties and risks remain. The mix of agricultural, energy and industrial disputes is very important for Trump's electorate and there is a risk that the trade war rhetoric will resurface during the next presidential campaign in the US, fuelling market volatility. Eyes will also be on Chinese economic data, to assess if recent policy implementation, has been successful, as we believe to reduce the risk of a hard landing. This would be a dangerous scenario for EMs and the world economy. On the economic side, this temporary deal does not change the outlook of a mild economic slowdown for the global economy, including the US, so it does not change our base

“We see the G20 deal as a short-term achievement that could bring some relief to the markets through the year end, more than as a game changer.”

¹ Fentanyl is part of a group of drugs known as opioids, also used in medical treatments.

scenario of a late cycle environment. In conclusion, we don't see the G20 deal as a game changer, rather as a short-term achievement that could bring some relief to the markets through the year end.

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