



Institute of Strategic and
International Studies (ISIS) Malaysia

The US-China Trade Conflict

Overview, impacts and responses

Calvin Cheng

Researcher in Economics, Trade and Regional Integration

calvin.ckw@isis.org.my



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US-China trade conflict: impacts of trade and investment diversion for Malaysia and the region

Policy responses in the region, effect on regional economic integration

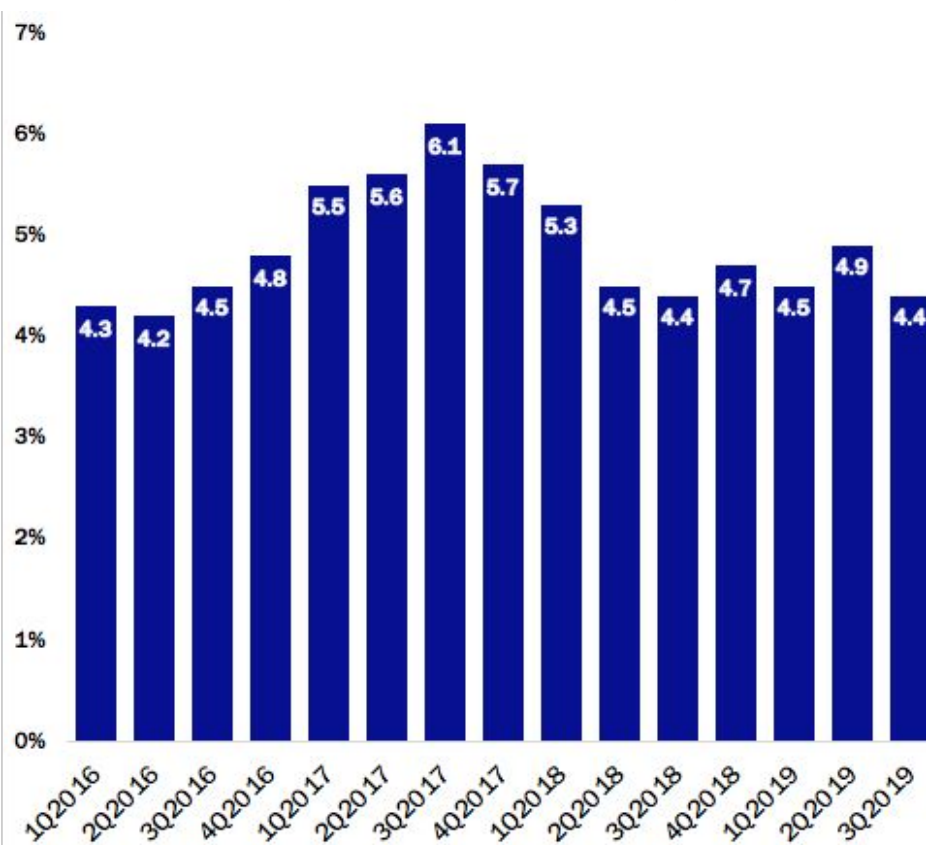
Malaysia macro overview

Some recent indicators



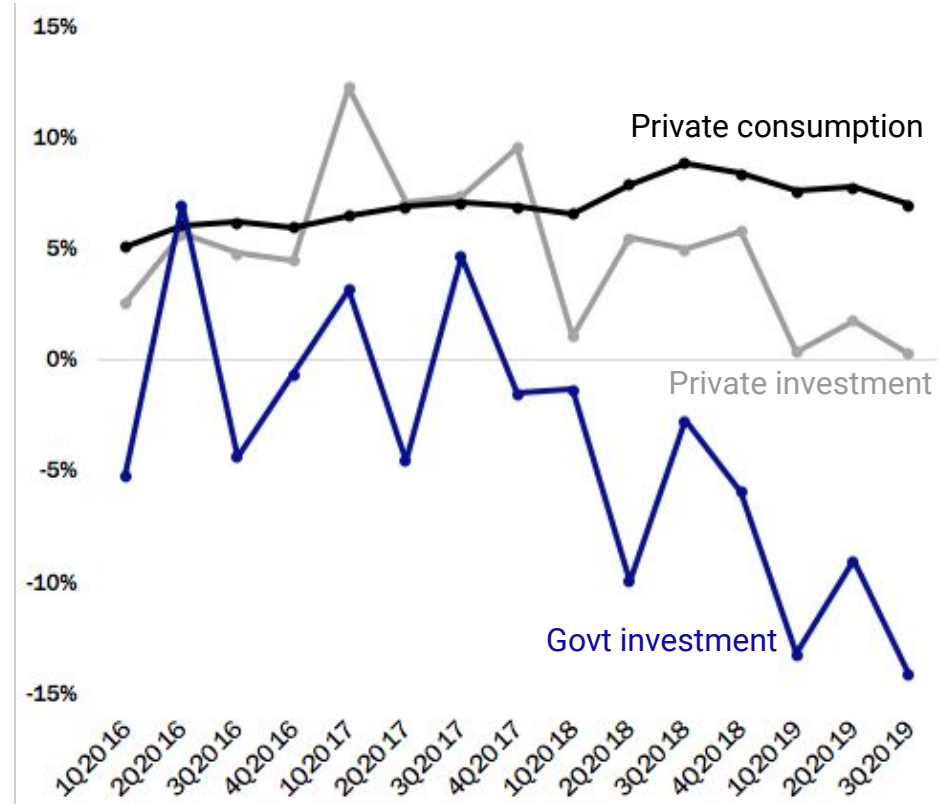
Malaysia's economy continues to grow but the pace of growth has moderated...

GDP growth (y/y% chg, constant prices)



...as government investment continues to decline and as pvt investment growth cools

GDP by expenditure (y/y% chg, constant prices)



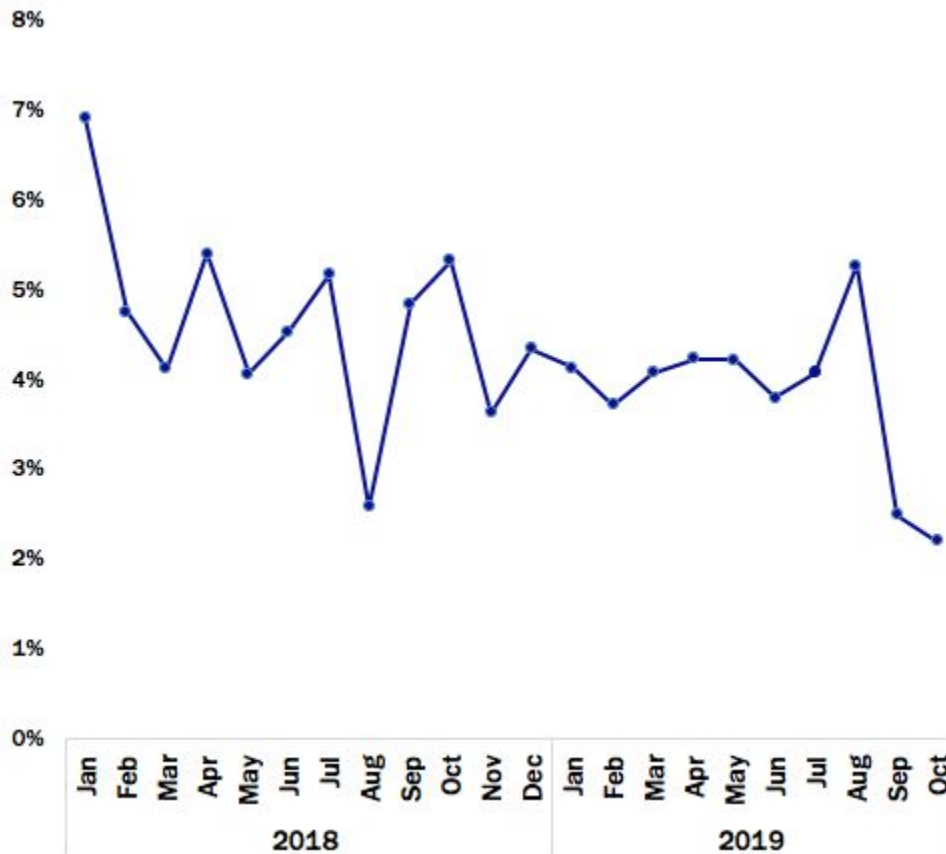
Malaysia macro overview

More recent indicators



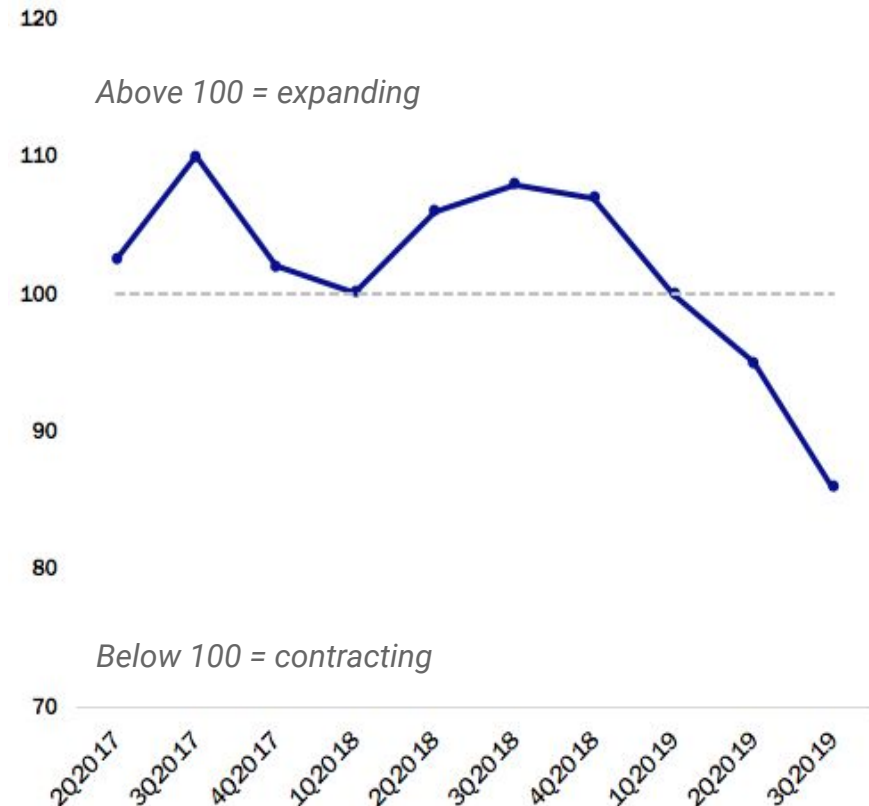
The global manufacturing recession has hit Malaysia's manufacturing production...

Industrial Production: Manufacturing (y/y chg%, SA)



...contributing to a decline in business sentiment and overall confidence

Business confidence (diffusion index, SA)



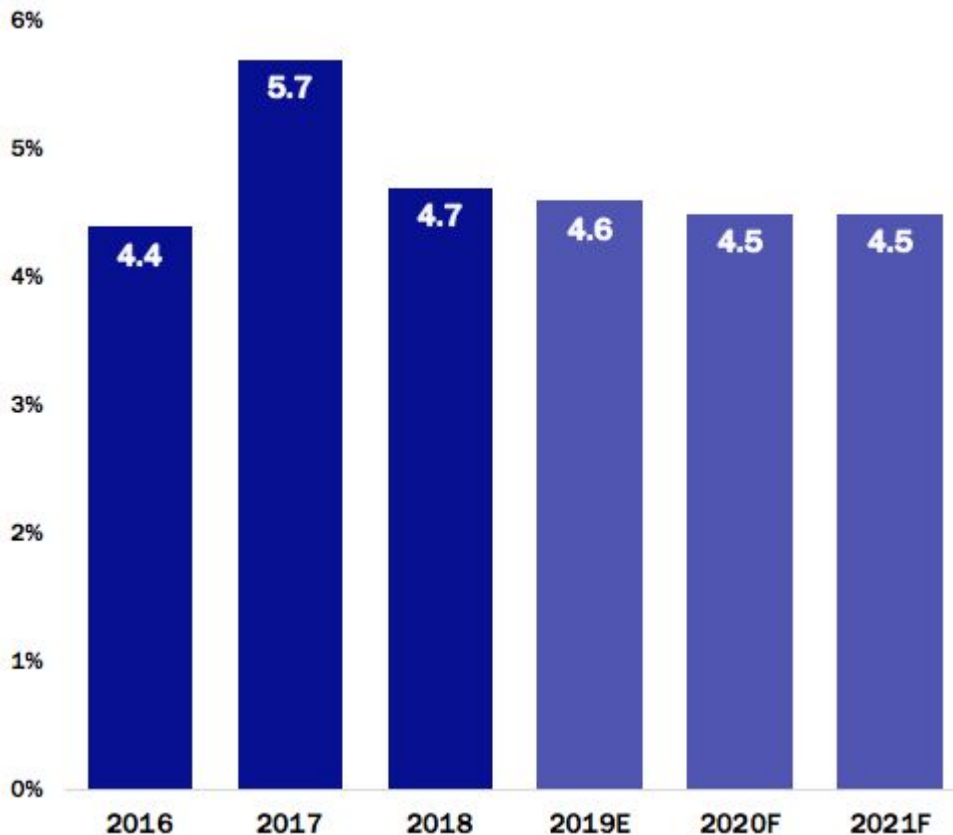
Malaysia macro overview

Growth outlook & emerging trends



Malaysia's GDP growth is expected to remain relatively resilient...

Industrial Production: Manufacturing (y/y chg%, SA)



Source: DOSM, World Bank estimates, ISIS-RCEI, Author's calculations

...despite rapidly emerging risks from both external and domestic sources

Results from stakeholder engagement

Top global risks

- Decline in world trade and demand
- Manufacturing recession
- Geopolitical uncertainty
- US and Chinese economic growth

Top domestic risks

- Political and policy uncertainty
- Declining consumer and business sentiment
- Manufacturing and mining slowdown
- Limited fiscal space

US-China trade timeline

A series of unfortunate events

 **Tariff action**  **Truce**

2018

Early 2018

Jan: US applies tariffs on **all washing machines and solar panel** imports

March: US applies tariffs on **all steel & aluminium** imports

July 2018

US applies **List 1 tariffs**

China retaliates with **China List 1 tariffs**

Aug 2018

US applies **List 2 tariffs**

China retaliates with **China List 2 tariffs**

Sep 2018

US applies **List 3 tariffs**

China retaliates with **China List 3 tariffs**

Dec 2018

US and China agree to a **temporary trade truce** at sidelines of G20 summit in Buenos Aires

2019

May 2019

US raises the tariff rate on **List 3 tariffs** from 10% to 25%

June 2019

US and China agree to a **temporary trade truce** at sidelines of G20 summit in Osaka

Sep 2019

US applies **List 4A tariffs** (15%) on \$120b Chinese imports

China retaliates

Dec 2019

Trump indicates possibility of splitting US-China trade deal into Phase One and Phase Two

As at December 12, Phase One deal has reportedly been agreed upon, to be signed in 2020

US-China trade timeline

Latest developments

Why this deal announcement is different from past “false dawns”...

Unlike past times, this time the US Trade Rep:

- Released a Fact Sheet
- Conducted a press briefing

What was agreed?

- US halts planned December (List 4B) tariffs, cuts List 4A tariff rates (25% to 7.5%) - 2/3s of tariffs REMAIN
- China agrees to increase agricultural purchases from the US and step up commitments on IP and forced tech transfer

...but don't get too optimistic yet either. Many issues remain unresolved

What's missing and what's left?

- **No actual deal document yet**
Legal scrubbing, translation, for signature in 2020 - details scarce
- **Thorny issues remain unaddressed**
The hardest issues like Chinese state subsidies are a phase two challenge
- **Bulk of the tariffs remain**
The US only cutting tariff rates on a *small percentage* of Chinese imports
- **Enforcement and actualisation**

Trade wars: general macroeconomic effects

Looking at the international evidence

Trade Wars

Direct effects

- **Lower global trade flows**
- Lower global GDP growth
- Higher consumer prices
- Increased uncertainty

Indirect effects

- Drop in investment due to **increased policy uncertainty**
- Lower productivity as global supply chains are disrupted
- Higher financing costs

ISIS Malaysia, Berthou et al. 2019.; Handley & Limao. 2017.

Case study: Evaluation of the US tariffs

- **US consumers bore the costs**
Higher input prices from the tariffs were mostly borne by US consumers
- **Net loss to US consumers and US economy**
Certain protected producers benefited, but overall net loss for the US economy and consumers

Welfare loss to US consumers



Trade wars: general macroeconomic effects

Net effect of trade wars are ambiguous a priori



In the region, **two** competing effects are in play...

1 A **negative** impact from a general reduction in world trade and global sentiment

Many key economies in the region, especially Malaysia, are:

- **Small and highly-open** economies with high trade dependence
- **Deeply integrated** with global and regional supply chains
- **Highly exposed** to the Chinese economy

2 Potential **positive** effects from trade and investment diversion as demand is diverted into the region

- **US\$165 billion***: Amount of goods that diverted per year to avoid tariff incidence is
- Many economies in the region have **similar export structures** vs the tariff-affected products

Two main avenues for trade diversion:

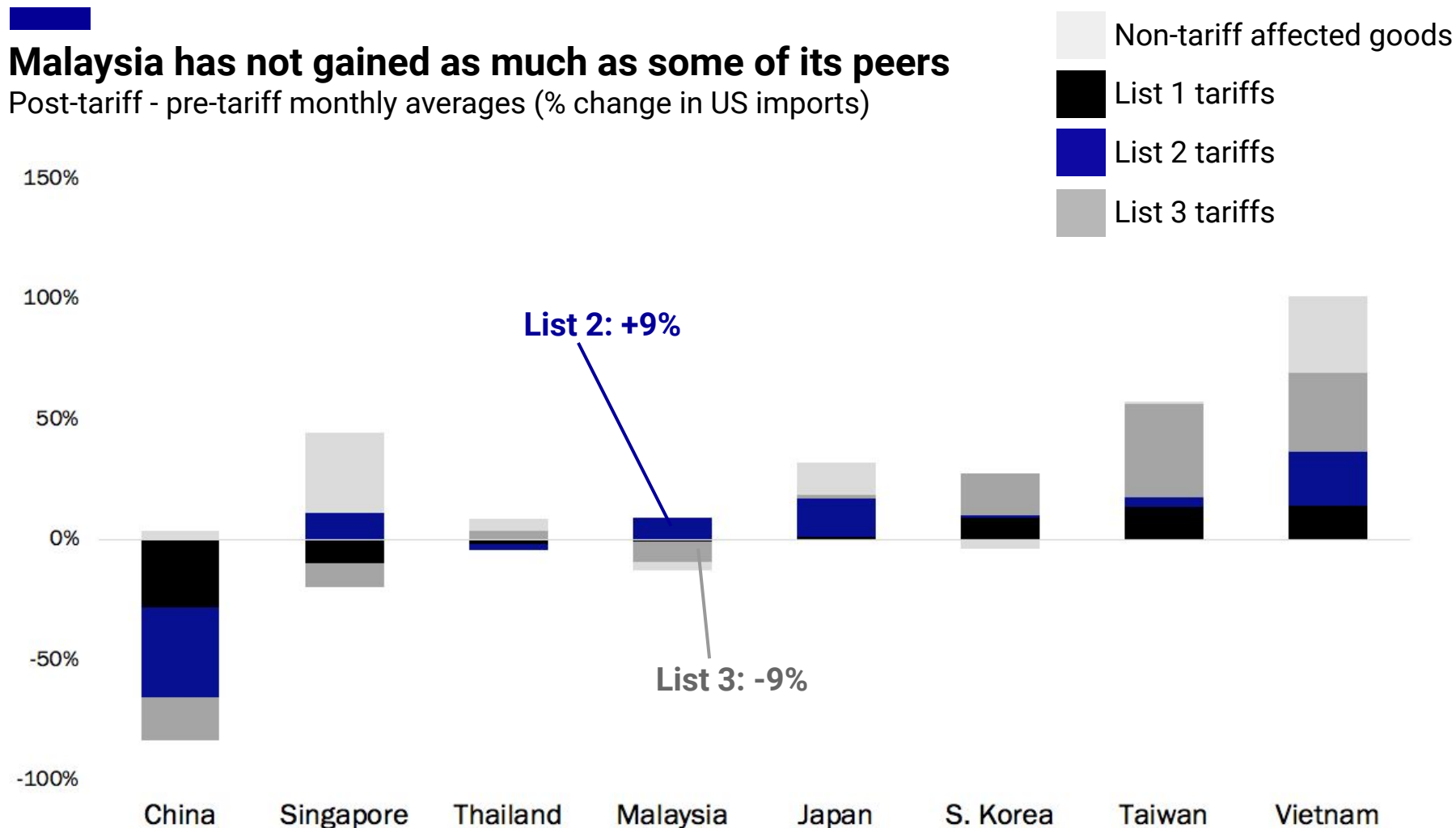
- Shifts in US import demand
- Shifts in Chinese import demand

*Amiti, Reading, Weinstein, 2018.

Analysis of the trade data so far: US imports



Which countries in the region have gained?



Source: US Census Bureau, Author's calculations, ISIS Malaysia Policy Brief #2-19

Note: Data until September 2019, List 4A products are counted as non-tariff affected due to USTR tariff effective dates

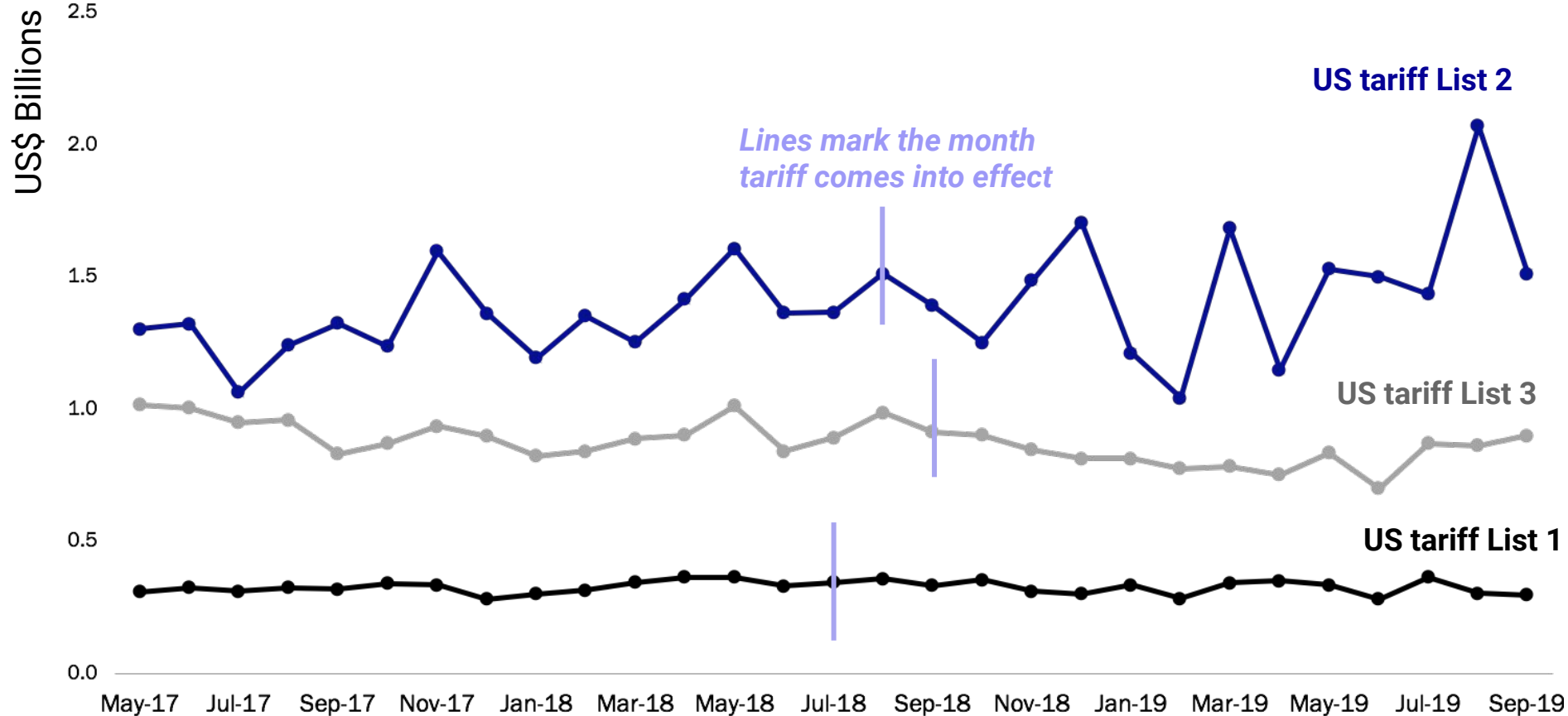
Analysis of the trade data so far: US imports

The Malaysian experience



Gain/loss in US imports, by tariff list

Post-tariff - pre-tariff monthly averages (% change)



Source: US Census Bureau, Author's calculations, ISIS Malaysia Policy Brief #2-19

Note: Data until September 2019, List 4A and \$B products are counted as non-tariff affected due to USTR tariff effective dates

Analysis of the trade data so far: US imports

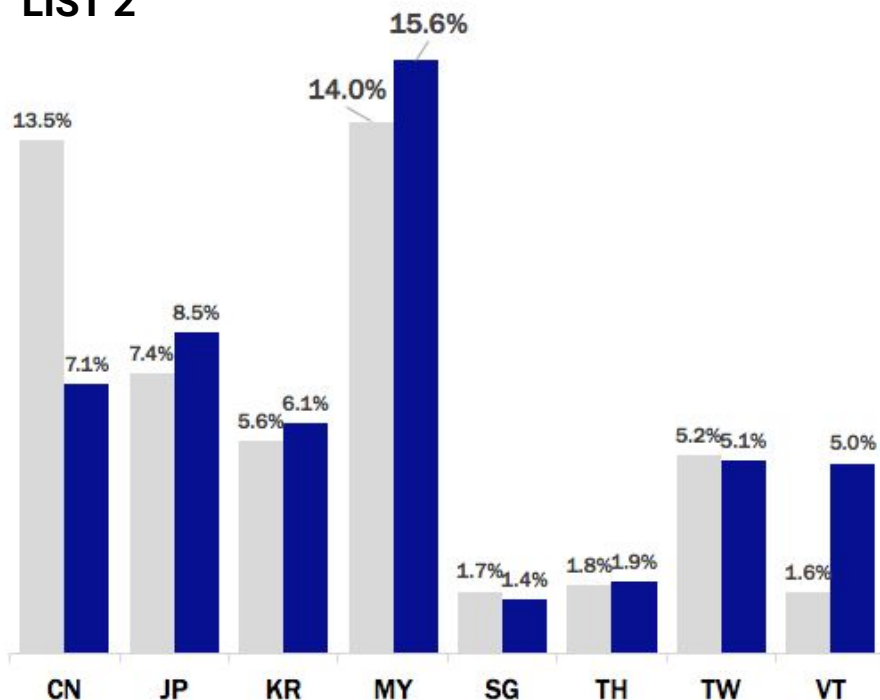
Looking at market shares



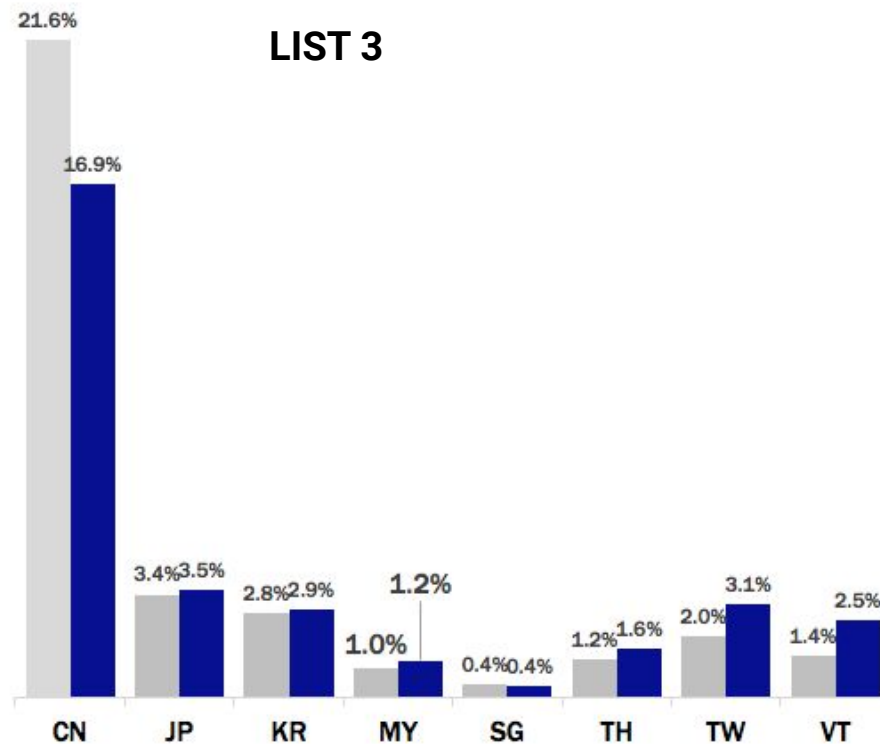
Malaysia (and other regional economies) have gained market share in the US for List 2 and List 3 products at the expense of China

% of total US imports by tariff list, by economy

LIST 2



LIST 3



Source: US Census Bureau, Author's calculations

Note: market share calculated as % of total US imports for each tariff group

Data until September 2019, List 4A products are counted as non-tariff affected due to USTR tariff effective dates

Analysis of the trade data so far: US imports

Which specific product lines have benefited? (HS 8-digit level)



Malaysia top gainers

Photosensitive semiconductor devices

Memory parts (RAM)

Printed circuit assemblies

Radio receivers used in motor vehicles

Medical rubber gloves

Non-medical rubber gloves

Electronic integrated circuits: processors and controllers

Telecoms instruments and apparatus

Instruments for measuring/checking semiconductors

Tantalum fixed electrolytic capacitors

Electro-medical instruments and appliances

Bedroom furniture

Industrialised Asia top gainers (Japan, Korea...)

Motor vehicle-related products and parts, batteries

Circuit assemblies

Aircraft-related products, parts, and fuel

Machinery and manufacturing components and parts

Other E&E parts and components

Developing Asia top gainers (Vietnam, Thailand...)

Wooden furniture, bedroom furniture, wood

Various E&E parts and components (circuits, LEDs)

Electric vehicle batteries

Food-related products (tuna, rice, frozen catfish)

Motor vehicles and tires (esp. Thailand)

Source: US Census Bureau, Author's calculations

Note: top gainers for industrialised and developing Asia are stylised summaries of top gainers for each grouping

Trade data up to July 2019

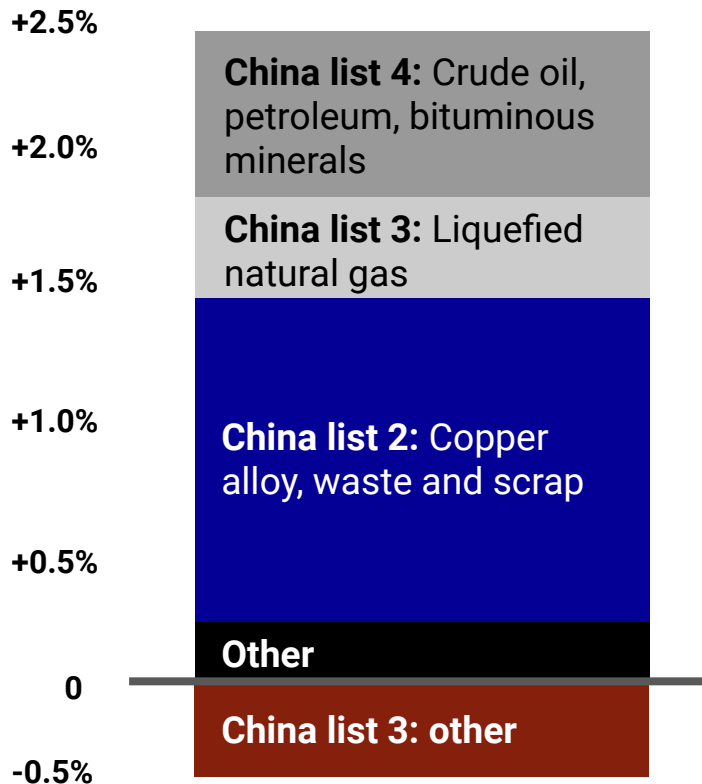
A quick look at shifts in Chinese imports

Has Malaysia gained in terms of Chinese demand?



Chinese imports of certain tariff-affected products from Malaysia has increased...

% change in Chinese imports from Malaysia (y/y% chg post-tariff vs pre-tariff, by tariff group)



...and these products are vastly different from the types of products that the US imports

Top gainers in M'sia exports to China (HS 2-digit level)

- Wood pulp; recovered paper scraps
- Iron and steel
- Lead and lead-related articles
- Pharmaceutical products; bandages
- Seafood
- Furskins and artificial fur-related products
- Tobacco and tobacco substitutes
- Explosives and pyrotechnic products
- Photographic or cinematographic goods
- Aluminium and articles thereof

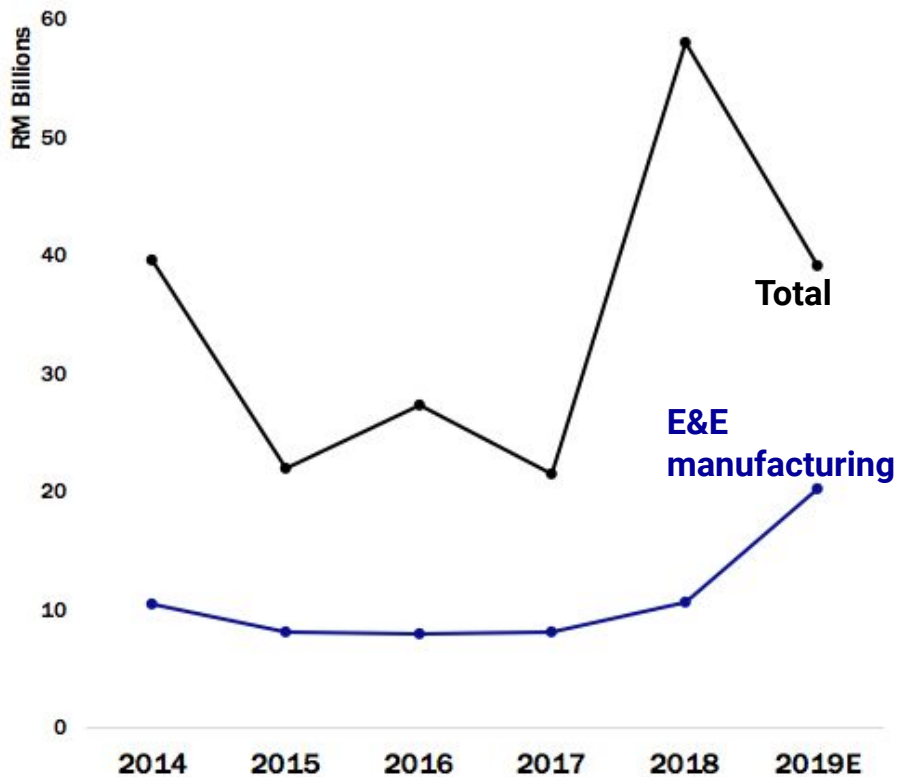
What about investment diversion in Malaysia?

Looking at FDI and Approved Investment data



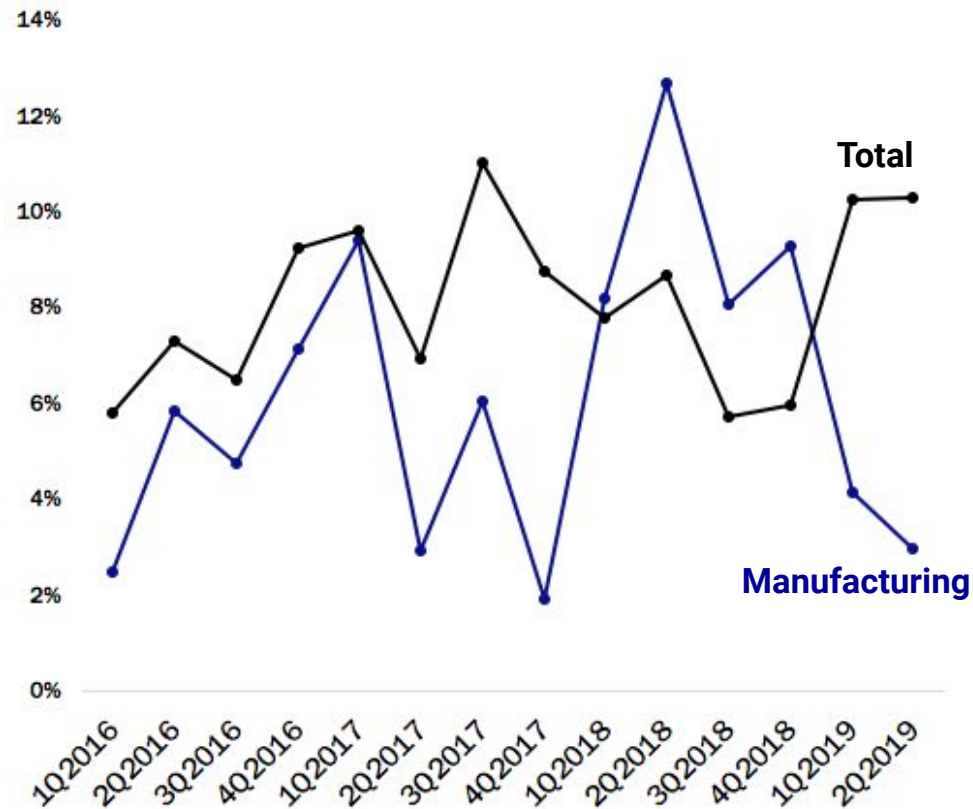
Approved investment in E&E manufacturing sectors has risen significantly in 2019...

Approved investment (RM billions)



...but this has only modestly translated into actual manufacturing FDI flows so far

FDI by sector (y/y% chg)



Regional government responses

What has already been done?



Malaysia

- Established **'trade war task force'** in MITI
- Established investment committee to **'fast-track' investment approvals**

Indonesia

- **Corporate rate tax cut:** 25% to 20% starting in 2021
- **Broad taxation reforms:** to value-added tax, income tax and general taxation

Thailand

- **Comprehensive stimulus package "Thailand Plus"** which includes:
 - Enhanced investment incentives
 - STEM Manpower development support
 - Automation investment support
 - Enhanced investment facilitation

How to win a trade war in the longer-run

What else can be done?



Shorter-term Policy Responses

Boosting trade and investment

- 1. Deepening regional integration with non-US regions**
 - a. ASEAN+
 - b. RCEP
 - c. CPTPP

- 2. Unilateral reforms**
 - a. Regulatory environment
 - b. IP regulations, labour standards

Longer-term Policy Responses

Industrial upgrading & human capital development

- 1. Industrial upgrading**
 - a. Maximising FDI benefits
 - b. Economic complexity
 - c. Technology upgrading

- 2. Human capital development**
 - a. Education + constant learning
 - b. Reducing inequality of opportunity

Potential impacts on regional cooperation

Some speculative trends up for discussion



US-China trade war (and Trump) brings Asia closer together

- US-China economic decoupling may **create opportunities for longer-term gains** for economies in the region
- **Creates impetus for closer regional integration**
 - China lowered its trade barriers for the R.O.W outside of the US
 - Generated urgency for countries in the region to complete RCEP negotiations
- World trading system/WTO reform

Increases momentum for Belt and Road Initiative (BRI) even amid financing issues

- The BRI has been affected by financing issues and economic stress amid the trade conflict
- But the trade conflict has also increased momentum for BRI projects across Asia
 - China is increasingly buying more from BRI countries
 - Belt Road Forum - BRI2.0

Key takeaways

- **Headwinds are building and recent data increasingly suggests that these external risks have already begun affecting the Malaysian economy**
- **Malaysia has seen trade gains for specific products to both the US and China. However, these gains have not been as large as some other regional economies--and these positive effects appear to be offset by the negative effects of a global slowdown in trade**
- **Policy responses to the US-China trade conflict should focus on deepening regional integration as well as unilateral reforms in the near-term and on industrial upgrading and human capital development in the longer-term**
- **The US-China trade war may have some limited positive effects on regional integration**

Thank you.

Questions & comments welcome.

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calvin.ckw@isis.org.my

Twitter: @calvinchengkw

www.isis.org.my/author/calvin/