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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Contents

- General macroeconomic overview and outlook for Malaysia
- 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)

Source: DOSM, Author's calculations
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)

Source: DOSM, Author’s calculations, Ambank Research
Malaysia macro overview
Growth outlook & emerging trends

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

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

...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

Source: DOSM, World Bank estimates, ISIS-RCEI, Author’s calculations
## US-China trade timeline

**A series of unfortunate events**

### 2018

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>Early 2018</td>
<td>Jan: US applies tariffs on all washing machines and solar panel imports</td>
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<tr>
<td></td>
<td>March: US applies tariffs on all steel &amp; aluminium imports</td>
</tr>
<tr>
<td>July 2018</td>
<td>US applies List 1 tariffs</td>
</tr>
<tr>
<td></td>
<td>China retaliates with China List 1 tariffs</td>
</tr>
<tr>
<td>Aug 2018</td>
<td>US applies List 2 tariffs</td>
</tr>
<tr>
<td></td>
<td>China retaliates with China List 2 tariffs</td>
</tr>
<tr>
<td>Sep 2018</td>
<td>US applies List 3 tariffs</td>
</tr>
<tr>
<td></td>
<td>China retaliates with China List 3 tariffs</td>
</tr>
<tr>
<td>Dec 2018</td>
<td>US and China agree to a temporary trade truce at sidelines of G20 summit in Buenos Aires</td>
</tr>
</tbody>
</table>

### 2019

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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</thead>
<tbody>
<tr>
<td>May 2019</td>
<td>US raises the tariff rate on List 3 tariffs from 10% to 25%</td>
</tr>
<tr>
<td>June 2019</td>
<td>US and China agree to a temporary trade truce at sidelines of G20 summit in Osaka</td>
</tr>
<tr>
<td>Sep 2019</td>
<td>US applies List 4A tariffs (15%) on $120b Chinese imports</td>
</tr>
<tr>
<td></td>
<td>China retaliates</td>
</tr>
<tr>
<td>Dec 2019</td>
<td>Trump indicates possibility of splitting US-China trade deal into Phase One and Phase Two</td>
</tr>
<tr>
<td></td>
<td>As at December 12, Phase One deal has reportedly been agreed upon, to be signed in 2020</td>
</tr>
</tbody>
</table>

Note: Timeline focuses on Section 301 tariffs, Section 232 tariffs were first imposed in January 2018
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**

Source: USTR, Bloomberg, Chad Bown
Trade wars: general macroeconomic effects
Looking at the international evidence

### 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

**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**
- From higher prices:
  - US$19.2 bil
- From reductions in real income:
  - US$6.9 bil

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?

Malaysia has not gained as much as some of its peers
Post-tariff - pre-tariff monthly averages (% change in US imports)

List 2: +9%
List 3: -9%

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

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)

<table>
<thead>
<tr>
<th>Malaysia top gainers</th>
<th>Industrialised Asia top gainers (Japan, Korea...)</th>
<th>Developing Asia top gainers (Vietnam, Thailand...)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Photosensitive semiconductor devices</td>
<td>Motor vehicle-related products and parts, batteries</td>
<td>Wooden furniture, bedroom furniture, wood</td>
</tr>
<tr>
<td>Memory parts (RAM)</td>
<td>Circuit assemblies</td>
<td>Various E&amp;E parts and components (circuits, LEDs)</td>
</tr>
<tr>
<td>Printed circuit assemblies</td>
<td>Aircraft-related products, parts, and fuel</td>
<td>Electric vehicle batteries</td>
</tr>
<tr>
<td>Radio receivers used in motor vehicles</td>
<td>Machinery and manufacturing components and parts</td>
<td>Food-related products (tuna, rice, frozen catfish)</td>
</tr>
<tr>
<td>Medical rubber gloves</td>
<td></td>
<td>Motor vehicles and tires (esp. Thailand)</td>
</tr>
<tr>
<td>Non-medical rubber gloves</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electronic integrated circuits: processors and controllers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Telecoms instruments and apparatus</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Instruments for measuring/checking semiconductors</td>
<td></td>
<td></td>
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<tr>
<td>Tantalum fixed electrolytic capacitors</td>
<td></td>
<td></td>
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<tr>
<td>Electro-medical instruments and appliances</td>
<td></td>
<td></td>
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<tr>
<td>Bedroom furniture</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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...

- China list 4: Crude oil, petroleum, bituminous minerals
- China list 3: Liquefied natural gas
- China list 2: Copper alloy, waste and scrap
- Other

...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

Source: Adapted in full from World Bank Malaysia Economic Monitor, December 2019 “Making Ends Meet” Box 2: The impact of US-China trade tensions on Malaysia’s exports, Figure 11; DOSM, China Customs Statistics,
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)

Source: Author’s calculations, MIDA, DOSM
Regional government responses
What has already been done?

<table>
<thead>
<tr>
<th>Malaysia</th>
<th>Thailand</th>
</tr>
</thead>
<tbody>
<tr>
<td>● Established ‘trade war task force’ in MITI</td>
<td>● Comprehensive stimulus package “Thailand Plus” which includes:</td>
</tr>
<tr>
<td>● Established investment committee to ‘fast-track’ investment approvals</td>
<td>○ Enhanced investment incentives</td>
</tr>
<tr>
<td></td>
<td>○ STEM Manpower development support</td>
</tr>
<tr>
<td></td>
<td>○ Automation investment support</td>
</tr>
<tr>
<td></td>
<td>○ Enhanced investment facilitation</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Indonesia</th>
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</tr>
</thead>
<tbody>
<tr>
<td>● Corporate rate tax cut: 25% to 20% starting in 2021</td>
<td></td>
</tr>
<tr>
<td>● Broad taxation reforms: to value-added tax, income tax and general taxation</td>
<td></td>
</tr>
</tbody>
</table>
### How to win a trade war in the longer-run

What else can be done?

<table>
<thead>
<tr>
<th>Shorter-term Policy Responses</th>
<th>Longer-term Policy Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Boosting trade and investment</strong></td>
<td><strong>Industrial upgrading &amp; human capital development</strong></td>
</tr>
<tr>
<td>1. Deepening regional integration with non-US regions</td>
<td>1. Industrial upgrading</td>
</tr>
<tr>
<td>a. ASEAN+</td>
<td>a. Maximising FDI benefits</td>
</tr>
<tr>
<td>b. RCEP</td>
<td>b. Economic complexity</td>
</tr>
<tr>
<td>c. CPTPP</td>
<td>c. Technology upgrading</td>
</tr>
<tr>
<td>2. Unilateral reforms</td>
<td>2. Human capital development</td>
</tr>
<tr>
<td>a. Regulatory environment</td>
<td>a. Education + constant learning</td>
</tr>
<tr>
<td>b. IP regulations, labour standards</td>
<td>b. Reducing inequality of opportunity</td>
</tr>
</tbody>
</table>
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.
The US-China Trade Conflict
Overview, impacts and responses

Calvin Cheng
Researcher in Economics, Trade & Regional Integration
calvin.ckw@isis.org.my
Twitter: @calvinchengkw
www.isis.org.my/author/calvin/