Fallout from the US-China trade war

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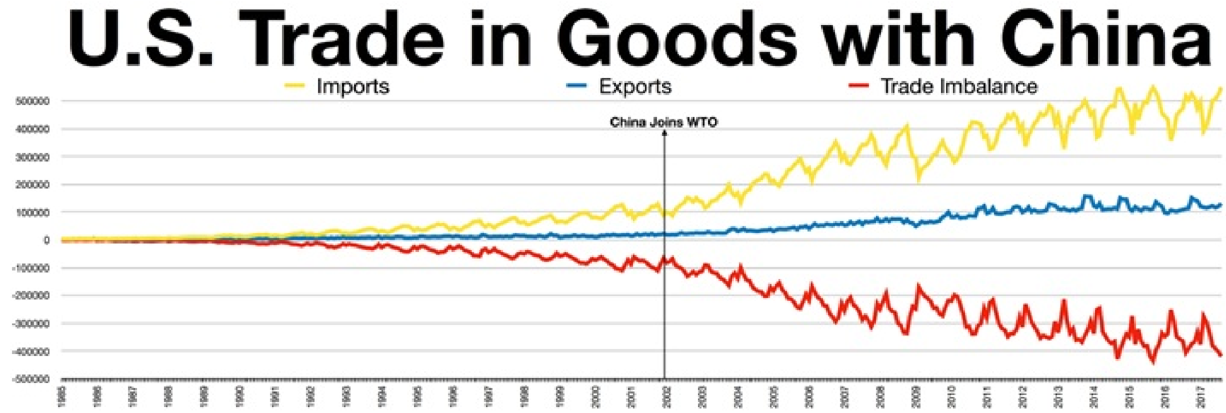
The ongoing trade spat between the U.S. and China may be heightening the risk of an impending economic slowdown and cause increasingly volatile financial markets as we begin the new year. In addition to rising costs due to trade barriers, any escalation of disputes between the two nations may cause knock-on harm to other export-reliant economies as well.



The diagram above illustrates the rapidly growing trade imbalance between the U.S. and China over the years. Given the sheer volume of trade and integration between the U.S. and China, trade tensions between these giant economies may give rise to reduced consumer expenditure as a result of increased tariffs, and consequently, prices of goods. A restriction on the flow of goods and services coupled with the U.S.'s concern over trade manipulation from the Chinese government are also likely to discourage investment as investors garner increasingly negative sentiments about international trade and the demand for goods and services. The IMF predicts a cut in global growth forecasts over 2019 as a result of the trade war taking a toll on global GDP while emerging markets struggle with tighter liquidity and capital outflows.

During the Global Financial Crisis of 2008, industrial production took a dip simultaneously as world trade volumes fell. Even though the underlying reasons for the fall in trade were different, the consequence is likely to be similar this time as increased tariffs give rise to increased costs of production for exporters and result in reduced margins for businesses. Moreover, there is also a potential that these increased costs for businesses may, in turn, be passed on to consumers, thus inducing inflationary pressure on the markets as well.

Source:CPB

On the positive side, however, there is a light of hope that major emerging markets like South Korea and Brazil are now better equipped to tackle a downturn than before, as emerging markets have focused upon conducting structural reforms to strengthen their economies in the past decade, effectively growing a safety net for themselves in the event of a downturn.

However, in spite of better-equipped economies, the risk of a global slowdown remains as U.S-China trade relations fester with no clear path to reconciliation.