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Better prospects for a relaxation in the commercial conflict between the US and China?

What follows is a sequence of questions and answers on key aspects of this conflict and that we have been able to obtain from several well-informed sources. This should also serve to determine what could be a plausible environment in which markets will move in 2019.

What are the arguments to think that a commercial agreement will finally take place? What are the arguments against?

In general, the sources respond that the case for a deal is that China seems to be happy to cut an agreement that gives it more breathing room. They highlight that through its sanctions on ZTE and now on Fujian Jinhua, Washington has shown that it can shut down major Chinese companies in an instant, threatening China's entire semiconductor plan, and putting Chinese national telecom company, Huawei, at risk. On the other hand, they mention that Trump needs a statesmanlike win that will position him for the 2020 presidential election as "the man who tamed China" (in their own words).

The case against a deal is that the US hardliners within the National Security and Trade teams (J.Bolton, Peter Navarro) have so far won every internal battle against the Free-traders team (Rex Tillerson, Gary Cohn).

By way of conclusion, while Mr. Trump might find it expedient to delay a deal with China until closer 2020, he is acknowledging that trade tensions are impacting not only stock markets but also corporate credit markets (financial conditions) and thus growth. This makes us think that Trump could cut a deal sooner than later.

What kind of truce could be declared?

The experts state that if a truce is declared it would probably take the same form as Trump's deal with EC's president Juncker in July (according to sources). This is a freeze on tariffs at current levels pending negotiations on the various issues on dispute. In the case of China, this would mean negotiations over a list of 140 demands that the US Treasury presented to Liu He over the summer.

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The good news is that Liu has already indicated that China can meet 40% of those demands soon (tariff levels and market access), and can address another 40% over time (issues related with technology transfer requirements or joint ventures). The bad news is that Liu suggested that China can not budge on the remaining 20% of demands (related with Beijing's strategy to continue running its industrial policy with big subsidies).

Is a No-deal a possible scenario? What about the consequences?

If a no deal scenario occurs, Trump would likely go ahead with his threat to bump up tariff's rates.

Trade representative R.Lighthizer and trade adviser Peter Navarro prefer a No-deal as they believe that much more pressure is needed to achieve their twin aims (thwarting China's economic and technological ambitions, and encouraging US firms to start moving investments out of China). If a no deal scenario occurs, Trump would likely go ahead with his threat to bump up tariff's rates on all imports from China (from 10% to 25%).

Is a Deal a more likely scenario than a No-deal? What could be the effects on financial markets of a pragmatic agreement?

But Trump needs a big win that could offer an opportunity to deflect attention from the recent electoral setback and legal pitfalls.

There is a strong argument to think that some kind of agreement will be reached soon (perhaps at the next G20 meeting on November 28 in Buenos Aires, as suggested by President Trump himself). As some political observers openly determine "Trump needs a big win that could offer an opportunity to deflect attention from the recent electoral setback and legal pitfalls". More importantly, "with the cost of tariffs falling on US consumers, and China preparing to offset any loss of exports with economic stimulus, it must be obvious now for Washington that Xi Jinping will not capitulate to some of the US aggressive demands". Thus, the only strategy for quickly securing a successful deal is by backing away from some unrealistic demands for China to stop using government subsidies and instead request Beijing for concessions in the areas of market access, intellectual property protection or agricultural imports, areas in which Beijing would already be taking steps.

If a pragmatic Trump-Xi deal is reached, the impact of the confrontation would shift from the macro level to the micro level. From questions related to global volatility to focus on specific sectors. But in general terms, this would represent a respite and a supportive step for financial markets.

Best regards.