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How to assess the impacts of US-China Trade Conflict on the Asian Emerging Economies

Misturu Yaguchi
General Manager and Chief Economist
Institute for International Monetary Affairs

In the US Mid-term Elections held on November 6, the Democratic Party won the majority seats of the Lower House, but its impact on the trade policy of the Trump administration seems to be limited. However, there is no end in sight for the US-China trade frictions, and there is even a possibility that they may be aggravated in some instances. Then, what kind of impacts will they have on the economies of the Asian emerging countries (except for China, the same applies hereinafter)?

In the first place, the Chinese export industries will be hit by the rise of the US import tariffs [a direct effect], but the emerging countries and regions in Asia, especially those in East Asia and Southeast Asia will see a decrease of their exports to China since they have been incorporated in the global supply chains centering around China (specifically they supply materials and parts to the Chinese assembly industries) [an indirect effect]. This will pose a factor of economic deterioration to the Asian emerging economies.

On the other hand, as is often pointed out, the United States has difficulty in domestically manufacturing replacement goods to the imported products from China, and has to import them from other countries than China. The beneficiaries of this will be the Asian emerging countries that have export goods in the relatively similar lineup with China [a trade conversion effect]. The increase of their exports to the US will be a factor to accelerate their economy.

The question is which of the above effects will exert stronger impact, (i) direct and indirect effects that will put downward pressure to their economy or (ii) a trade conversion effect that will pump up their economy. This problem will require some quantitative analysis, but according to the researchers at the Asian Development Bank (ADB)[1] and universities[2], the latter view is more predominant. For example, the estimate of ADB shows that when the hike of the US customs tariffs is to be confined to the already implemented level[3], the real GDP of the Asian emerging economies[4] as a whole will be raised by 0.06% as the latter effect works stronger (Table 1). By country, the business improvement effect will be larger in Vietnam, Malaysia, and Thailand. And in the case that the US-China conflict should further escalate, and they mutually impose 25% tariffs on all of their imports from the other, the real GDP of the entire emerging countries in Asia will pick up by 0.22%.

Table1：Estimates of impacts of US-China Trade Conflict on the Asian Emerging Economies (ADB Economic Outlook)

Items	Calculation Methods	Effect on the Real GDP of the Emerging Economies in Asia	
		Already Announced	Conflict Escalates
(i) Direct and Indirect Effect	・Decrease of demand due to higher import prices caused by the raise of the tariffs is calculated by using price elasticity. ・Further impacts through the global supply chains are calculated by using the ADB Multi-Regional Input-Output Tables.	Minus 0.05%	Minus 0.09%
(ii) Trade Conversion Effect	・The effect is estimated by assuming that the half of the import items subject to the tariff increase is to be reviewed so that the import source conforms to "the global share of the items".	Plus 0.11%	Plus 0.31%
Combined Effects		Plus 0.06%	Plus 0.22%

(Note) The ADB Multi-Regional Input-Output Tables (the 2017 version) cover 35 industry sectors in 62 countries and regions (including 24 countries and regions in Asia). For details of the scenarios (“Already Announced” and “Conflict Escalates”), refer to the text and footnotes above.

(Source) Based on ADB

[1] ADB, “Asian Development Outlook 2018 Update,” Sep. 26, 2018, page 28-31

[2] Tsutsumi, Masahiko: “The Economic Consequences of US-China Trade Conflicts of 2018, CGE Simulation Analysis”, Discussion Paper No. 672, Center for Intergenerational Studies, Institute of Economic Research, Hitotsubashi University, October 2018 (in Japanese)

[3] The U.S. imposed 25% tariffs in June 2018 on $34 billion worth of total imports of $500 billion from China and another $16 billion worth in August. In September the US imposed 10% on another $200 billion worth of imports from China (to be raised to 25% from January 2019). In response China has taken retaliatory measures.

[4] The ADB analysis covered 44 countries in East Asia (excluding China), Southeast Asia, South Asia and Central Asia.

As stated above, the analyses of ADB and universities conclude that the growth of the emerging economies in Asia will be raised by the US-China trade conflict as the trade conversion effect is larger than negative impact. However, it should be noted that these analyses do not take into account that the rising future uncertainties will lead to a drop in corporate investment sentiment and negative impact on the financial market. Not a few experts also put emphasis on this point. For instance, Mr. Sudhir Shetty, Chief Economist for the East Asia and Pacific Region of the World Bank, argues that it is not so easy for the Asian emerging countries to substitute the Chinese exports to the US, and above all it is necessary for us to take into consideration a decline of corporate investment in the Asian region.[5] In the speech of Mr. Kuroda, Governor of the Bank of Japan, which was made on November 5, he introduced a view that the impact of protectionist policies on the global economy varies, largely depending on the extent to which it spreads to the corporate investment sentiment and global financial markets in addition to the direct effect of downward pressures on the trade activities.

Needless to say, it is difficult to forecast a future rise of uncertainties and negative impact on the financial markets. For reference, the International Monetary Fund (IMF) estimates in its World Economic Outlook[6] as follows. Assuming that (i) the business sentiment of the US firms worsens by about one sixth of the decline at the time of the global financial crisis and (ii) the US corporate earnings decline by 15%, the IMF calculation finds a decline of corporate investment due to the assumption (i) above and an increase of credit spread due to the assumption (ii) above, and the IMF supposes we will see similar situation in other countries and regions. The impact of the (i) alone on the world real GDP will amount to minus 0.2-0.3%, and combined impacts to minus 0.4-0.5%. Although the IMF does not show an estimate for the group of "the emerging countries in Asia", these effects will also arise to some extent in the Asian emerging economies. Especially when the impacts of (i) and (ii) arise simultaneously, the positive trade conversion effect will be completely offset, and an economic downturn will be inevitable in the whole emerging countries in Asia.

In reality, corporate investment sentiment and financial markets are affected by various factors, and the above assumptions of the IMF and the results of calculation thereof are just one of the hypotheses. However, the financial and foreign exchange markets in the Asian emerging countries have already become somewhat more unstable partly due to the successive interest rate hikes by the US Federal Reserve Board. Given the high possibility of prolonged trade conflict between the US and China, we should take a fairly cautious attitude to the growth prospect of this region.

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[5] Duong, Hai, "Asian economies / War profiteering," *The Economist, Oct. 27th 2018,* page 64-65

[6] IMF, "World Economic Outlook October 2018," Oct. 9, 2018, page 33-35