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Global Risk Watch Newsletter

From the US to Emerging economies via China: Financial Crisis Express is finally departing?, etc.

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1. Overview Macroeconomic and Financial Risks (Trends & Topics)

 # From the US to Emerging economies via China: Financial Crisis Express is finally departing? (Tsuyoshi Oyama, Partner/Head of Center for Risk Management Strategy (CRMS) at Deloitte Touche Tohmatsu LLC/Deloitte Asia Pacific Risk and Capital Management Leader)

The US-led trade war is showing signs of getting more serious. In addition to the tariffs already levied on major countries' steel and aluminum, the US has also levied the first volley of additional tariffs (USD 34 billion) meant to correct the US/China trade imbalance. At the same time, the Chinese have levied commensurate retaliatory tariffs on the US. The global economy, and particularly the American economy, is very strong at the moment, and there is not yet widespread concern that impacts from a trade war will be felt immediately. However should things continue in this vein, there is a growing chance that emerging countries' currencies or risky assets like stocks will falter.

In this context, the Chinese economy is of greatest concern. Indicators that the world's second largest economy is slowing down have recently increased while Chinese stock prices continue to decline. The causes of the slowdown seem to lie in stagnating infrastructure investment and consumer spending - perhaps because of the effects of stronger regulations on the expanding shadow banking industry as well as monetary tightening in the past months. Amid all of this, exports are still robust. The trade surplus with the US for the first half of the year set a new record. However, it may also be said that this was the impact of a rush to do business before raised tariffs go into effect. If we take this as the case, it may become difficult for China to expect the same levels of external demand.

From a policy standpoint, it looks like the Chinese government is growing more resolved in its softened stance on structural adjustment measures. Taking the above situation into account, the Chinese government appears to be doing whatever is necessary to lessen the impact of softening domestic demand to avoid a sharp economic slowdown – all of this at the expense of delaying measure to address current economic imbalances. Authorities have also allowed the RMB to fall sharply against the USD. This is likely a gambit to prop up external demand should the trade frictions get any worse.

If the Trump administration expands the current additional tariffs on USD 50 billion worth of Chinese imports to include the recently announced new tariffs on USD 200 billion imports, this will impact a little over half of all imports to the US from China. As a result of retaliatory tariffs on American goods, food prices (including soybeans) have also risen in China. There is concern that this price rise will further depress consumer spending there. Moreover, once it becomes clear that the Chinese economy is in the phase of growth deceleration, this could cause further drops in stock prices and the RMB. This may in turn tip off a negative feedback loop that affects the stock prices in neighboring countries as well as depressing the currencies in emerging countries. Coupled with concerns over rising US interest rates, the likelihood that emerging economies will feel a pinch from this situation is growing.

While the US and Chinese economies can temporarily absorb the impacts of the large scale US-led trade war, the spillover effects on emerging economies may not be so easy to bear. We may have to start thinking about a scenario where the results of this trade war first trigger an emerging economies' crisis, which will then lead to another global economic crisis.

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