



What's standing in the way of a US-China trade deal?

Tariff rollbacks, agriculture purchases have remained topics of debate

Nov 11, 2019 | Kristina Hooper, Chief Global Market Strategist

In the last two months, I have had the pleasure of meeting with clients in a variety of different countries in Europe and Asia, as well as the US. There is one issue that all of these clients are interested in: the US-China trade conflict.

The last several weeks have seen sentiment grow increasingly positive around US-China trade relations in general and, specifically, a US-China trade deal (albeit just "Phase 1"). The most positive news of all came on Nov. 7, with reports that a Phase 1 deal had basically been finalized and that it would include the rollback of some tariffs. China's Ministry of Commerce spokesman Gao Feng announced that day, "In the past two weeks, top negotiators had serious, constructive discussions and agreed to remove the additional tariffs in phases as progress is made on the agreement."¹

US President Donald Trump contradicted that assertion on Friday morning, explaining that he has not agreed to roll back tariffs on China. However, markets barely flinched. There has continued to be an assumption on the part of markets that Phase 1 of the trade deal is a fait accompli. Hence, the rise in US Treasury yields, the drop in gold, and the rise in equity prices. Japanese stocks have been doing particularly well in recent months.

However, as I have said before, I am not confident that even Phase 1 of the trade deal is guaranteed to happen. That's because I think there is a good chance that China will condition the signing of Phase 1 on a rollback of some tariffs - something I believe will be difficult for the US to agree to. After all, Phase 1 doesn't tackle the hard-core issues that are a major part of the US-China trade conflict, such as intellectual property rights and access to markets, so it doesn't behoove the US to make any significant concessions in the first phase.

Agriculture remains an issue

But never say never: The US is very desirous that China re-start its agricultural purchases, so it might just cave in. And although China was expected to already begin buying more agriculture from the US, it seems that those purchases have not yet begun, likely due in part to a major drop in the number of pigs in China, given a culling of the herd due to swine fever. (Last week's report from China's General Administration of Customs showed that China imported 6.18 million tons of soybeans in October, which is the lowest level since March and is down 24.6% from 8.20 million tons in September.)² Having said that, buying agriculture is one of the biggest bargaining chips that China has. US farmers have been hurting, and the Trump administration has been eager to alleviate their suffering, especially as the 2020 election nears. If China is not getting tariff relief in Phase 1, then it may not find it worthwhile to increase agriculture purchases from the US going forward.

And China has the luxury of waiting, as its economic data appears to be stabilizing. The Caixin China Composite PMI Index for October clocked in at 52.0, slightly up from 51.9 in September.³ And while China has continued to sustain damage from the trade war, it appears to be moderating. China's exports in October fell 0.9% from a year earlier, which was less than expected - and far better than its decline of 3.2% in September. While exports to the US dropped 11.3% from January to October, exports to the European Union rose 5.1%.⁴ And exports to Southeast Asian countries rose significantly, suggesting a back door through which exports are being sent to the US.

But perhaps the most compelling data supporting the fundamental strength of the Chinese economy can be found in Singles Day purchases. Singles Day is the 24-hour shopping extravaganza in Asia pioneered by Alibaba more than a

decade ago. Early reports from this year's Singles Day (Nov. 11) indicate a strong consumer willing and eager to spend. According to the South China Morning Post, Chinese consumers collectively spent 268.4 billion yuan (US\$38.4 billion) on Singles' Day. This set a new record, up from approximately \$30.8 billion in 2018.⁵

This data suggests that, while the Chinese economy remains under pressure, it may easily tolerate the situation and may not be forced into any concessions that it is not fully comfortable with.

Market implications

However, the possibility that a Phase 1 deal falls through has market implications. In my view, failure to secure such a deal would be likely to send risk assets such as stocks downward. In such a scenario, Treasury yields would likely go down and gold would likely go up. While my base case remains that a Phase 1 deal comes to fruition, the risks are increasing - especially the risk that it could be delayed. I must stress that investors should prepare for - but not be frightened by - the possibility that a Phase 1 deal does not come to fruition or is delayed significantly. I believe any kind of resulting sell-off would be relatively muted and short-lived because of the cushion being created under risk assets by central bank accommodation. And any resulting sell-off could represent a buying opportunity for investors with longer time horizons.

Source

¹Source: Bloomberg News, "U.S. Says Phase-One China Deal Would Include Tariff Rollback," Nov. 7, 2019

²Source: CNBC, "China October soybean imports fall 10.7% from year earlier- customs," Nov. 7, 2019

³Source: IHS Markit, Caixin, Nov. 5, 2019

³Source: South China Morning Post, Nov. 8, 2019

³Source: South China Morning Post, Nov. 11, 2019

Important information

Blog header image:

All investing involves risk, including the risk of loss.

A basis point is one hundredth of a percentage point.

The S&P 500® Index is an unmanaged index considered representative of the US stock market.

The Chicago Business Barometer™ is a weighted composite indicator made up of five sub-indicators, namely New Orders, Production, Employment, Order Backlogs and Supplier Deliveries. It is designed to predict future changes in gross domestic product (GDP). Survey data is collected online each month from manufacturing and non-manufacturing firms in the Chicago area.

The Purchasing Managers Index (PMI), a commonly cited indicator of the manufacturing sectors' economic health, is calculated by the Institute of Supply Management in the US.

The opinions referenced above are those of the author as of Nov. 11, 2019. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.

This document has been prepared only for those persons to whom Invesco has provided it for informational purposes only. This document is not an offering of a financial product and is not intended for and should not be distributed to retail clients who are resident in jurisdiction where its distribution is not authorized or is unlawful. Circulation, disclosure, or dissemination of all or any part of this document to any person without the consent of Invesco is prohibited.

This document may contain statements that are not purely historical in nature but are "forward-looking statements", which are based on certain assumptions of future events. Forward-looking statements are based on information available on the date hereof, and Invesco does not assume any duty to update any forward-looking statement. Actual events may differ from those assumed. There can be no assurance that forward-looking statements, including any projected returns, will materialize or that actual market conditions and/or performance results will not be materially different or worse than those presented.

The information in this document has been prepared without taking into account any investor's investment objectives, financial situation or particular needs. Before acting on the information the investor should consider its appropriateness having regard to their investment objectives, financial situation and needs.

You should note that this information:

- may contain references to amounts which are not in local currencies;
- may contain financial information which is not prepared in accordance with the laws or practices of your country of residence;
- may not address risks associated with investment in foreign currency denominated investments; and
- does not address local tax issues.

All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. Investment involves risk. Please review all financial material carefully before investing. The opinions expressed are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

The distribution and offering of this document in certain jurisdictions may be restricted by law. Persons into whose possession this marketing material may come are required to inform themselves about and to comply with any relevant restrictions. This does not constitute an offer or solicitation by anyone in any jurisdiction in which such an offer is not authorised or to any person to whom it is unlawful to make such an offer or solicitation.