

# US-China Trade Talks

## Why things are getting tricky

- Unfortunately, the positive developments in the US-China trade conflict did not last long. The risk of going into renewed escalation over the coming weeks is going up.
- The key challenge is how Trump can both satisfy a strong domestic call for tariffs on Chinese technology without China leaving the negotiation table and go back to retaliation.
- While we still believe the ultimate solution will not entail a trade war, the probability that things will get worse in the short run is clearly going up. In addition, it highlights that this theme will continue probably for a long time. Keep an eye on China's response on 15 June when Trump plans to announce the specific list of targeted goods for USD50bn of Chinese imports.
- A return to a 'tit-for-tat' pattern would increase the fear of a trade war and probably give a hit to risk appetite.

## What just happened?

Two weeks ago things started to look good in the US-China trade conflict with the deal between US and China in which China agreed to 'substantially reduce' its trade surplus with the US, see *US-China trade talks: 'Grand bargain' moving closer*, 22 May 2018. China also committed to strengthen protection of intellectual property rights and open up more investments. After the deal the US Treasury Secretary said on Fox News 'We're putting the trade war on hold, so right now we have agreed to put the tariffs on hold while we try to execute the framework.'

This was all good news. However, it did not last long. Trump immediately faced strong criticism at home from fellow Republicans and Democrats for being too soft on China. Republican Senator Marco Rubio for example *tweeted* 'Sadly China is out-negotiating the administration & winning the trade talks right now... This is #NotWinning'. Things are not made easier by the fact that the US midterm elections are coming up in November, the protectionist forces are strong in some states and the Republicans are way behind in the opinion polls.

On 29 May, one week after Mnuchin said the trade war was on hold, Trump announced tariffs on Chinese goods worth USD50bn in a press *statement* headlined 'President Donald J. Trump is Confronting China's Unfair Trade Policies'. It seems the announcement is a direct response to the criticism of China out-negotiating the US. The list of products subject to tariffs will be presented on 15 June and will be products primarily within the 'Made-in-China 2025' strategy, which is dominated by technological products.

China said in response that it 'urged US to keep its promise...' and that it would take 'resolute and forceful' measures to protect its interests, see *Reuters*. Over the weekend the Chinese leadership then warned the US that the trade promises will 'not go into effect' if the US puts any sanctions - including additional tariffs - back on the table, see *SCMP*. The negotiations over the weekend when US Commerce Secretary Wilbur Ross was in Beijing were mainly about the details of China's increased purchases of US products within energy and did not as such bring new things on the table.

### Key dates to watch

**15 June:** US announces the list of targeted goods worth USD50bn of Chinese goods.

**30 June:** US announces investment restrictions and export controls on China.

Tariffs and restrictions to be imposed "shortly" after the announcement

No further meetings between China and US are scheduled at this point.

Source: White House statement

### Chief Analyst

Allan von Mehren  
+45 4512 8055  
alvo@danskebank.dk

### Senior Analyst

Mikael Olai Milhøj  
+45 4512 7607  
milh@danskebank.dk

## Escalation to come

The development puts the negotiations in a very difficult state. **It looks very difficult for Trump to move back from the USD50bn of tariffs on Chinese technological products.** This would trigger significant criticism from both other Republicans as well as Democrats.

**Could China offer something to avoid the tariffs? We doubt this.** China has already gone a long way to meet Trump. It has thus promised to buy more US products, has announced a reduction in tariffs on a long list of products, committed to increased protection of intellectual property rights and opened up further for investments into China. The US tariff also serves to limit China's technological development, which means it may not matter how much China offers on the trade front.

**We thus find it likely that we could soon end in a situation of further escalation.** We expect China to do what it says and take the offer off the table and may even retaliate by putting tariffs on US products worth USD5bn as well. This would take us back to the original scenario when Trump first announced tariffs on China. Could China choose not to respond? We do not see this as very likely as it would undermine their credibility and cause a loss of face. They are willing to meet Trump and give concessions at the negotiating table. But China will not allow itself to be 'bullied' by Trump, as it would be seen in China.

**Another key question then becomes, how would Trump respond to Chinese retaliation?** There is a risk that he pulls out the USD100bn of Chinese exports subject to tariffs once again to step up the pressure on China. And then we are back in the 'tit-for-tat' pattern that could take us into trade war. If Trump really believes the US would win a trade war as he again tweeted this weekend, then he might choose that road.

## 'Grand bargain' further away - but you never know with Trump

**The recent developments has, in our view, clearly put the risk of a trade war back on the table.** If this is confirmed later this month, we expect it to hit risk appetite. The 'Grand bargain' that we have argued for may be further away than we thought.

**Given the costs of a prolonged trade war, our baseline is still, though, that some kind of deal will be struck eventually but the latest development highlights that this theme will probably haunt us for a long time, as trade wars are slowly fought.** There is also the caveat that you never know what the next step is with Trump and whether it is all just part of a negotiation game. The North Korea talks are also coming up on 12 June adding another dimension to the situation. So stay tuned. The pendulum could suddenly swing in the other direction again as seen a few times before.

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