Philequity Corner (May 28, 2018)
By Wilson Sy

Trade War On Hold?

Since the first set of tariffs were announced on March 1, trade war concerns have kept a lid on stocks. The global bull market took a pause, with some stock markets correcting sharply (see *Trade wars*, 26 March 2018). This escalated when the US specifically targetted China, with both sides announcing one retaliatory tariff after another. However, despite the combative rhetoric from both sides, most people were hopeful that a full-blown trade war would not come to pass. Many hoped that after the initial round of talks in Beijing, negotiations between the US and China would come to a positive and amicable conclusion.

Mnuchin – We are putting the trade war on hold

This optimism was reinforced when US Treasury Secretary Steven Mnuchin declared that "we are putting the trade war on hold". In a TV interview about a week ago, Mnuchin said that **"US and China have agreed to put tariffs on hold while we try to execute a framework"** for addressing trade imbalances in the future. Although China did not accede to the US' demand to reduce the trade gap between the 2 countries by $200 billion, Mnuchin said that they "have specific targets… they go industry by industry." Some of the proposed measures are the following:

1. **Increasing Chinese imports of US agricultural and energy products**
   Mnuchin expects a 35-40% increase in US agricultural exports to China in 2018, as well as the doubling of energy-related exports over the next 3-5 years
2. **Lower the tariffs on more US products**
   China has imposed tariffs on a wide range of US products, but they announced that they will be lowering those related to some car parts and vehicles. Effective July 1, the Chinese Finance Ministry said that tariffs on certain vehicles will be cut from 25% to 10%, while levies on some car parts will be lowered to 6%.
3. **Resolve issues on intellectual property, cyber theft and forced technology transfers**
   Among the biggest sticking points in trade negotiations, White House officials have pushed China on this matter.

Trump in a very positive mood

In response to this news, Chief Economic Adviser Larry Kudlow said that President Donald Trump is in a "very positive mood about this". In fact, Trump ordered Commerce Secretary Wilbur Ross to find a way to put ZTE back in business after paralyzing restrictions that threatened the company's survival. This is in sharp contrast to Trump's previous behavior where he blasted China in his tweets, claiming that the US has been abused and treated unfairly. These acts were welcomed by investors and help rekindle bullish sentiment in the market.

A man of contradictions

When he tweets, Trump tends to contradict his Cabinet members. Oftentimes, he even contradicts himself. Just days after Mnuchin's TV interview, Trump made an about face and doused hopes of a quick resolution to trade issues. From feeling "very positive", Trump now said that he is "not satisfied" with the ongoing negotiations, adding that both countries "have a long way to go" before reaching a deal. This sudden change in Trump's reaction to trade talks nipped the budding bullishness in equity markets.

Everyone loses in a trade war

The reason so much attention is being given to these developments on US-China trade is because the outcome will affect not just the two countries, but the entire world. With the advent of globalization, the supply chains of countries from the Americas to Europe to Asia are all interconnected. Thus, any disruption in the flow of trade will be detrimental to everyone. During the trade war of the 1930s, not only was the US plunged into a recession, global growth also ground to a halt. Thus, contrary to Trump's assertions, if a full-blown trade war comes to pass, everyone loses.

Uncertainty creates volatility

It is precisely Trump's mood swings, flip-flopping and vacillating opinions that are causing volatility in the market. From being blusterous and belligerent, Trump can suddenly become amiable and conciliatory, only to abruptly revert to his aggressive stance. Thus, each statement from White House either sends investors jumping for joy or running for cover. With each heave and haw of the market dependent on developments on the trade front and Trump's statements, volatility will continue to remain elevated. This situation has made investors quite hesitant to deploy their cash and buy stocks. In times like this, it is sometimes best to sit tight, monitor the situation and wait for the smoke to clear.

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Crude oil price plummets

Many people have been up in arms over the tax reform package (TRAIN). They are blaming the government for our above forecast inflation. Some legislators are even proposing that the excise tax on oil be scrapped in order to put a lid on rising prices. However, as we said in a past article, TRAIN is not to blame for our inflation woes. In fact, bulk of our inflation figure is actually due to the sharp increase in crude oil prices (see *Rising oil prices – Culprit behind high inflation & current account deficit*, 14 May 2018).

Last Friday, a reversal happened. With OPEC and Russia considering the easing of output caps on oil production, crude oil plunged 5%. This sharp drop in oil prices may finally provide a respite for Filipinos as it may put the brakes on our inflation. This may also silence parties who are blaming TRAIN for our economic woes. In fact, Friday may have a marked a peak in crude oil prices. If this reversal continues, it may change the entire outlook for inflation and the Philippine economy.

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