US-CHINA TRADE WAR

Prelims: Economics- International Economics

Mains: GS-III- Effect of policies and politics of developed and developing countries on India's interests, Indian diaspora.

- **Context:** Researchers at Morgan Stanley have alerted that if US and China continue to heap increasing tariff and non-tariff barriers over the next four to six months, the world economy could enter a recession within the next three quarters.

Origin of the US-China dispute:

- The US and China have been slugging it out since Trump slapped heavy tariffs on imported steel and aluminum items from China in March last year, and **China responded by imposing tit-for-tat tariffs on billions of dollars' worth of American imports.**
- The dispute escalated after **Washington demanded that China reduce its $375 billion trade deficit** with the US, and introduce **"verifiable measures"** for protection of Intellectual Property Rights, technology transfer, and more access to American goods in Chinese markets.

What is a Global Recession?

- In an economy, a recession happens when output declines for two successive quarters (that is, six months). However, for a global recession, institutions such as the International Monetary Fund tend to look at more than just a weakness in the economic growth rate; instead, they look at a widespread impact in terms of the impact on employment or demand for oil etc. The long-term global growth average is 3.5 per cent. The recession threshold is 2.5 per cent.

What has Triggered the Alarm?

- On August 1, trade tensions between the two biggest economies of the world escalated further when the **US announced that it would impose 10 per cent tariff on imports from China**.
- These measures are to come in to effect from September 1.

China threatened to take Countermeasures:

- In retaliation, China threatened to take countermeasures.
- The **US has also declared China a "currency manipulator"**.

- In other words, the **US accuses China of deliberately weakening the yuan to make Chinese exports to the US more attractive** and undercut the effect of increased tariffs that the US is employing.

What is Currency manipulation?

- Currency manipulation refers to actions taken by governments to change the value of their currencies relative to other currencies in order to bring about some desirable objective.
- The typical claim – often doubtful – is that countries manipulate their currencies in order to make their exports effectively cheaper on the world market and in turn make imports more expensive.

- The renewed trade tensions threaten to derail the already struggling global economy.
- For instance, the **global manufacturing Purchasing Managers' Index** and **new orders sub-index** have contracted for the second consecutive month in July; they are already at a seven-year low.
- Further, the global capital expenditure cycle has "ground to a halt"; since that start fo 2018, there's been a sharp fall-off in nominal capital goods imports growth.
- **Central banks around the world are cutting interest rate in a bid to shore up global economic activity.**
- To some extent, that **cheap money policy** is countering the adverse impacts of trade wars and all-round global uncertainty, thanks to Brexit and geopolitical tensions in West Asia, and between the US and North Korea.

How do higher tariffs affect growth?

- According to Morgan Stanley, **two-thirds of the goods being lined up for increased tariffs are consumer goods.** Higher tariffs are not only likely to douse demand but, most crucially, hit business confidence.
- The apprehension is that the latest US tariffs and similar countermeasures by China could start a negative cycle wherein businesses do not feel confident to invest more, given the lower demand for consumer goods.
- Reduced capital investment would reflect in fewer jobs, which, in turn, will show up in reduced wages and eventually lower aggregate demand in the world.
- What makes this scenario tricky is that fact that monetary policy is already loose.
- Ideally, the global economy should not risk reaching a recession at a time when the monetary levers may not have a lot to offer.
- In fact, at present, the trade tensions and uncertainty is negating the positives that a cheap money policy could provide to the world economy.

How India is impacted by US-China trade war?

- There could be a short-term impact on the stock markets.
- The benchmark Sensex at the Bombay Stock Exchange has been falling in line with global markets that have been spooked by the escalating trade war between the US and China.
- In the longer run, while a **slowdown in the US economy** does not augur well for emerging markets, the trade war could have a silver lining for some countries.
- **India is among a handful of economies that stand to benefit from the trade tensions** between the world's top two economies, the United Nations has said in a report.
- **Other countries set to benefit from the trade tensions** include Vietnam, with 5% export gains, Australia (4.6%), Brazil (3.8%), India (3.5%), and Philippines (3.2%), the UNCTAD study said.

The value of the Indian Rupee:

- In the last one month, the value of the rupee has dropped to an all-time low, when in some occasions it was hovering around the mid 68s against the US dollar.
- This coincided with Donald Trump's threat of imposing a fresh round of tariffs on exports worth $200 billion.
- This trend can be traced to the **weakening of the US dollar, which automatically creates a negative impact on the trade deficit of India,** causing a chain reaction of sorts.

India-US duties

- As the United States of America imposed duties on steel and aluminium, India now has to pay approximately $241 million worth of tax to the US.
- India, on the other hand, as a **counter-measure has proposed imposing duties on 30 different types of goods.**
- This will ensure that the US has to pay about $238 million as duties to India.
- However, this will make life more difficult for the end consumers as everything that falls under the tariff scanner is expected to become more expensive.