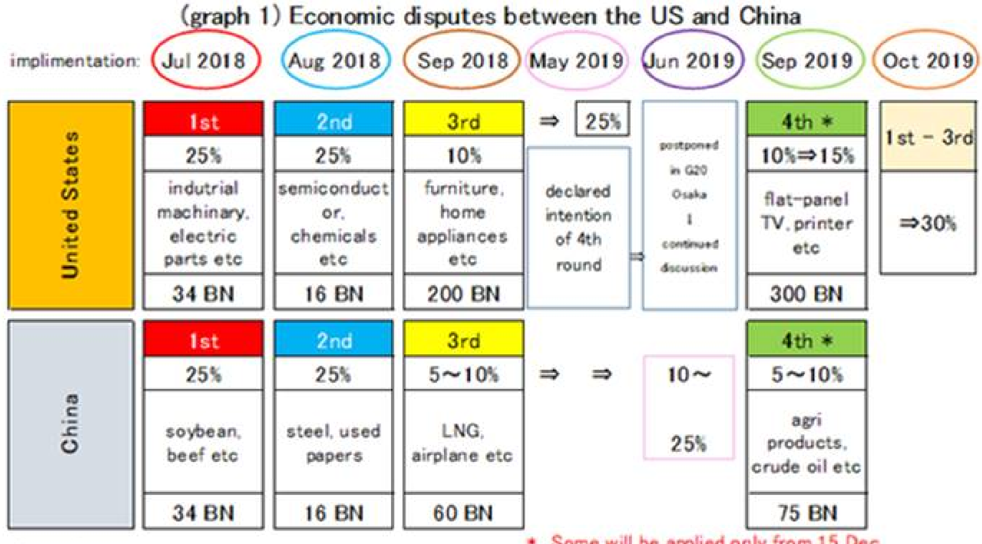
Introduction

The US-China economic dispute has been drawn into a quagmire. Since the US and China together consists 40% of the world GDP, the negative effect of the dispute on global economy is significant. In this paper, I will briefly argue the implication of the US-China economic dispute on the global real economy, monetary policy and financial markets. Although I try to reflect the latest outcome, be kindly reminded that this paper is based on the information obtained in the mid-September.

Prolonged Dispute

The economic dispute between the US and China has been escalating since last year. Trump Administration announced their intention to raise the tariff for selected import from China to as high as 30% from October. Chinese government is also conducting countermeasures (graph 1).

(graph 1) Economic disputes between the US and China



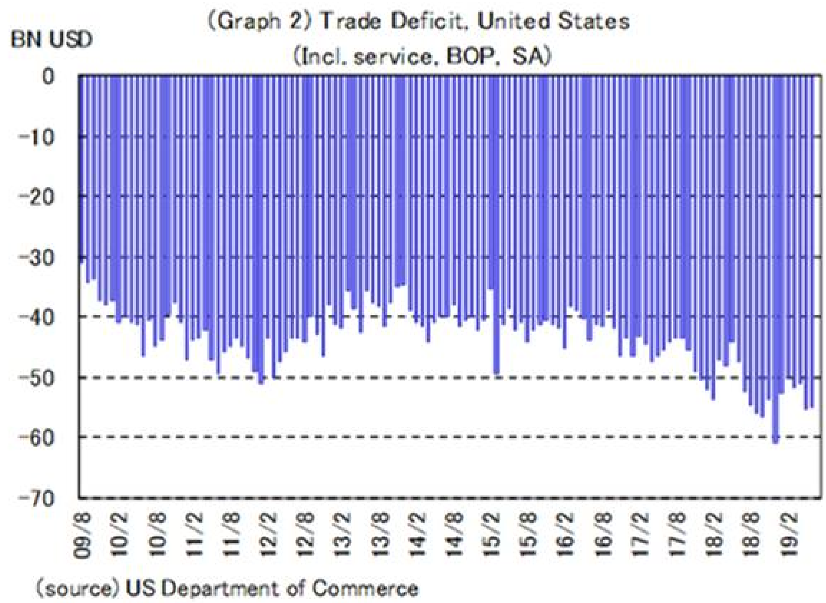
(source) Meiji Yasuda Life

World Economy

Pessimistic view on global economy due to the intensified trade war is spreading widely. The spillover effect of US-China economic dispute is not limited to the two players. Since the both together consists about 40% of the world GDP, clearly it is not too much to say that the consequence of this dispute determines the global economic outlook over a few years.

United States

In the US, it is worth noting that the overall trade deficit is still widening, rather than shrinking, even after the inauguration of President Trump (graph 2). This is because the export is increasing at slower pace than the increase of the import, partially reflecting the weakening global economy and China's countermeasure. Although the trade deficit against China is shrinking, that against the NAFTA and against the EU are widening significantly.



From the view of the national accounting, macroeconomic net export (export - import) is determined by the Investment-Savings balances of the domestic private sector and the public sector. In the US, IS balance is negative since the governmental deficit is larger than the surplus of the private sector. Therefore, reducing the trade deficit between China will be automatically offset by increase of the trade deficit from the rest of the world unless they change the domestic IS balance structure. Therefore, we do not expect the trade deficit to be neutralized in foreseeable future.
As for the overall US economy, at the current juncture, we expect it to continue recovering, while its pace will remain sluggish. Improving labor market and increase of the corporate profit will keep supporting the economy. Moreover, - an ounce of prevention is worth a pound of cure - FED's rate cut will underpin the consumption and investment.

China
Chinese economy is slowing down. Clearly the decrease of the export, which consisted 19% of the GDP in 2018, is dragging the economy down. New export order PMI suggests China's export to decrease at the faster pace than now until the end of 2019 (graph 3). Some of this weakness might reflecting the restructuring of firms' global supply chain; ASEAN countries, e.g., Vietnam and The Philippines are regarded as the promising production bases next to China.

（source）General Administration of Customs, National Bureau of Statistics of China

Domestic demands are also in the downturn. Consumption has been increasing at the slower pace than that of the disposable income, indicating that Chinese households are increasing the precautional saving instead of consuming today. The possibility is that households are more concerned about future employment situation because of the uncertainty over the economic dispute. Both manufacturing and service employment confidence are worsened.

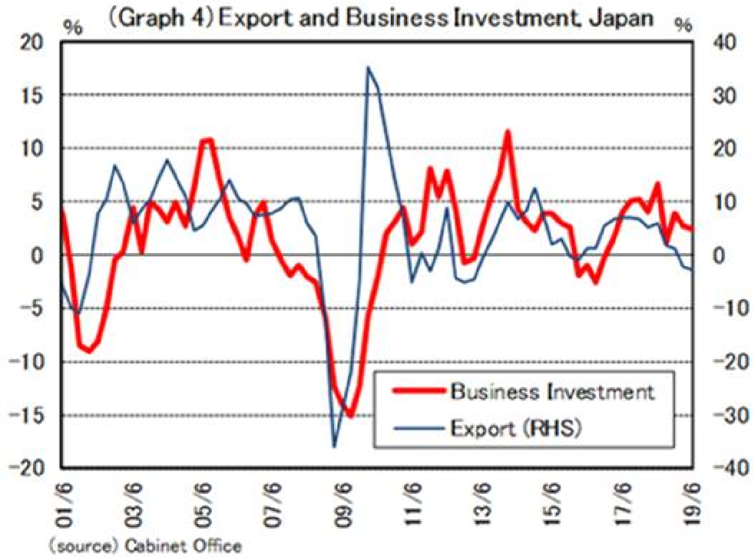
Facing the sluggish export and domestic demands, we expect that the Chinese government will announce the additional fiscal stimulus package to boost the fixed asset investment this autumn. As seen before, the stimulus will prevent the economy from falling into recession. However, due to the weakening export, we expect the economy to recover at slower pace than before.

Japan
So far Japanese economy is showing somewhat resiliency against the Economic Dispute. 2Q real GDP growth rate was +1.0% in year-on-year basis, which is not lousy taking it into consideration that the economy’s potential growth rate is estimated to be below 1.0%. the strong growth was fueled by strong consumption and business investments.

Having said that, the outlook is rather gloomy. Besides the direct impact of global economic slowdown, there are some concerns over the outlook of domestic demand.
First and most importantly, the government of Japan is going to raise its value added tax rate to from 8% to 10% this October. Although some measure to stabilize the last-minute-demand and the following plunge of consumption are taken, the decline of the real income due to higher tax rate is likely to hurt the household expenditure in the longer run.

Secondly, since the linkage between the export and business investment is becoming more significant these days, now that it is hard to expect the quick recovery of business investment, despite the firm

demand of domestic labor saving investments (graph 4).
Taken together, it is likely that Japanese economy will stagnate over 2020.



Eurozone

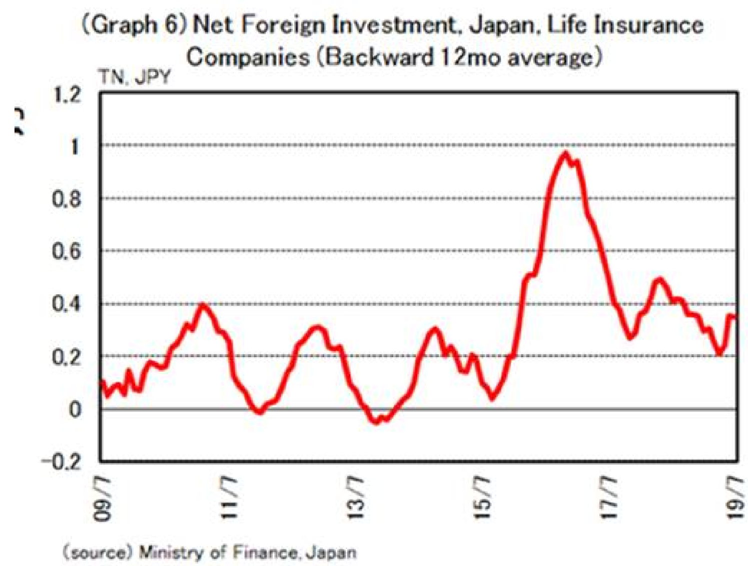
Although Berlin is 7,400km away from Beijing and 6,700km from DC, downturn of export due to the economic dispute is weighing down European economy, which has already been shaken by Brexit. Among Eurozone countries, Germany is most hardly hit, since German economy has large exposure on manufacturing.

The business climate of German manufacturing industry is at the lowest since 2009 in August (graph 5). Negative spillover from underperforming manufacturing sector is now spreading to service sector too. Additionally, households are more concerned about weakened labor market, which incentivizes them to tighten their belts. Despite the fact that European Central Bank's accommodative monetary policy stance are fueling the economy, it is hard to expect strong recovery in European economy for a few years.

Monetary Policy and Financial Markets

Since the Economic Dispute increase the uncertainty of global economy, central banks are taking the monetary policy easing. The Federal Reserve implemented "preventional" rate cuts in July and September. This action was followed by rates cut and announcement of restart of its quantitative easing program by ECB in September. In this sense, the Economic Dispute turned central banks from tightening to easing again.

Monetary policy easing, together with the uncertainty over global economic outlook and arguably the global secular stagnation in the longer run, pushing the yield of sovereign bonds down globally. Negative long term interest rates in Japan, Germany, France, Sweden, Netherland and Switzerland encourage investors in these countries to invest in foreign assets. Some of these money outflow is injected into the US market. As Former Federal Reserve Chair Ben Bernanke mentioned, we believe that such global imbalance is contributing to bring down the yield in the US further. In other words, low interest rates are "exported" from Europe and Japan. For instance, life insurance companies in Japan are purchasing foreign assets at escalated pace (graph 6).



Conclusion

The economic dispute between the US and China has been escalating. Since both of the US and China are economic giants, the negative effect of the dispute on global economy is tremendous. To tackle the headwind, central banks are taking accommodative measures, which encourages the interest rates to stay extremely low; in some cases, negative. At the current juncture, it is difficult to expect the global ultra-low interest rate environment to come to an end in the near future.