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ECONOTE No. 74: The 2007-8 US crisis and the present "trade war" : Don't believe in "fake news" 31/7/2018

Summary	Investment Conclusions
The title of this Econote is purposely sarcastic and even provocative. We have always maintained that the 2007-8 financial crisis was as American as apple pie, and insisting that it was "global", flies to the face of hard evidence. Same now with the notion that the present US tariffs amount to a trade war and they may lead to global recession. The aim of this Econote is to take a hard look at facts and place them in perspective as to what is going on in the global financial and trade markets. The truth about economic commentaries is, that, we all look at the same numbers and come to completely different conclusions! Econotes keeps firmly in mind the sad fact that arguments are about facts and not about opinions!	Fears that the impact of the tariffs will drag the world into a recession brought memories of the 2007-8 crisis. The evidence we present supports the argument that the 2007-8 crisis in the US had a short negative impact on global GDP growth but had little or no impact on the financial and banking sectors of most economies excluding the US and a few EU members. The current tariff war will likely cost a few basis points of growth, but mostly to the US and China. This macro conclusion must be tempered by the impact of the tariffs on individual companies, which could be severe, but these involved are also likely to be mostly American

The story so far

The US initiated tariff "war" (please note the quotation marks) has two basic elements.Firstly, tariffs are imposed on specific countries and on some, but not all of their products, that is China, Canada and Mexico and, secondly, tariffs imposed on a very limited number of specifc products only, such as steel, aluminium, washing machines and solar panels. Not all producers of these goods are affected, as some steel exporters, such as Brazil, were exempted and S.Korea negotiated a quota rather than a tariff.Threats to impose tariffs on car imports to the US have dissipated.The application of these measures by the US has been strangely selective.Mobile telephone imports from China are exempted so far, thus letting Apple off the hook. With the exemption of the 3 specific countries involved, which have retaliated, only the EU which was not targetted as a "country" but rather the countries in the EU which export steel to the US, has also retaliated by tariffs on selected US imports.All this is is damaging to specific companies, especially American ones, which have found the costs of their inputs rising but with no added competitive advantage at home.However all this can hardly be called a "war". There has been deafening silence, for example, from Japan and from Australia. Most of the smaller Asian countries are not exporters of steel or of washing machines and, hence, have not been affected at all. The stock markets have been unsettled while the G3 central banks have kept a perverse stance by assuming opposing tracks.The BoJ stays with "pedal on the metal" and with zero rates, the ECB is considering hikes but it has signalled, that it will end QE.The Fed is about to hike for the eighth time. Notwithstanding Brexit, the BoE just hiked. What does all this tells us ? These monetary authorities are not concerned yet with the trade war. In Asia, China has moved to loosen, with injections of credit, but India has just hiked rates. Fig.1 points that during the 2007-8 financial crash, GDP growth rates of the G3 economies and those of Asians and of Australia all fell but recovered fast.

Fig.1: GDP growth yoy (2007=100) -2018

Source: Bloomberg: US (red), EU (blue), Jap (Orange) China (Yel), India (violet), Australia (Green) S.Korea (Brown)

Comparing consequences

The 2007-8 crisis dented GDP growth in all major and minor economies.However the impact on the financial sectors of these economies was so diverse as to make the term “global financial crisis” suspect. Consider these facts. The US banking sector was,for a while, effectively nationalised with the Fed either funding directly major and minor banks or simply extending loans to allow recapitalisation.To a lesser extent, the same happened in the UK with the state buying outright RBS and partially Lloyds.In Ireland the rush promise by the state to guarantee the capital basis of the banks led to a major fiscal crisis, and the irresponsible lending of Icelandic banks also led to defaults.The German state had to support some banks and especially regional ones. And as for Asia, absolutely nothing happened to any of the banks with the exception of a minor Indonesian bank.No Japanese banks had to be rescued, nor Indian, Singaporean, S.Korean, Filippino, let alone Hong Kong

Fact Box: The impact of trade wars: not as bad as it sounds

The following is an excerpt from a SCMP article (24/7/18) by Prof L.J.Lau of the CUHK on the expected impact on China of the decline in its exports because of the US tariffs.
“Assuming a complete fall of all exports of targeted products to the US, total Chinese exports to the world will fall by 9.4%. The fall in exports may be estimated at 1.7% (of China’s) GDP. However since the direct domestic value added content of Chinese exports to the US is less than 25%, the actual direct loss in GDP may be estimated at only 0.43 percent…. Thus the decline in Chinese GDP in the first instance will not exceed 0.5%.... second…third… rounds effects of the reduction in exports (may) imply a total loss in Chinese GDP of 1.12%”
Unfortunate but hardly serious.

or Chinese banks needed urgent recapitalization or rescuing as the result of the collapse of the US property market and, hence, of the US banking sector. The Chinese and other Asian authorities extended credit and loosened up monetary policy, which is far from buying out failed banks. As Fig. 2 shows the trends of 3M interests in major and minor Asian economies did not show any persistent signs of crisis or panic and indeed rates rose from 2009, but afterwards they followed independent paths.

What is the relationship of all this to the current tariff crisis and “trade war” ? It is simply the same process of the “Americanization” of the 2007-8 crisis which from “American” became “global” despite the fact that it was not. Now Trump’s drive for higher tariffs for 3 named countries and for some of their products, and of 3-4 named products irrespective of provenance, has become a “global trade war”.

At the risk of being repetitious we wish to emphasize, that ,in the same way that a financial crisis, which affected massively only the US financial system, was eventually termed “global” despite the fact that it had little of no effect on Asian, Japanese, Australian and Latam banks, the American trade war with 3 countries and 4-5 products became “global trade war”.

Fig.2: 3M rates (or equivalent) 2007=100 to 2018

Source: Bloomberg Red (USD libor), Orange (Shibor), Mauve (India TB), Blue (Bibor), Green (S.Korean CP)

Conslusions ? Nothing is what it seems…….

There is justified concern that the trade war with 3 countries could spread and that, even if it does not spread, will have collateral effects.Imposing tariffs on Chinese exports could impact supply chains and have unexpected impacts on unrelated third parties.American users of steel and aluminium are finding that tariffs on these products far from increasing the competitiveness of domestic steel and aluminium producers it actually reduces the domestic competitivenss of users of steel and aluminium such as producers of white electrical goods, canned drinks etc.

As the introduction of US tariffs has led an upsurge of near existential introspection as whether the world has now moved from global rules and order to a wild west of individualism and bilateral deals, Econotes raises its voice to counter this virulent form of Americanocentrism.What happens in the US is important, but not half as important as it is claimed to be.It is time to focus to what the rest of the world is doing, which is not dismantling world order, and deprive the Trump type of politics of its oxygen: publicity and reverential importance.It merrits neither, not because it is “bad” but because, once examined, it is not at all what it seems.

Andrew Freris (writing completed 31 July 2018)