G20: Curb Your Enthusiasm, Fade Trump's Threats

- **Any Trump-Xi meeting and possible pause on tensions is unlikely to set in motion a rollback of existing tariffs, but the White House will remain reluctant to impose its threatened tariffs on the remaining USD 300 bn of annual US imports from China.**
- **Canada is unlikely to see any relief out of Osaka from its worsening tensions with China.**
- **Bolstering WTO reform may get some lip service in the G20 communiqué, but don't expect it to lead to any action.**

TRUMP & XI: TALKING TO KEEP TALKING

The bilateral meeting between Presidents Trump and Xi planned for Saturday remains the main event at the Osaka G20 Summit, but it is unlikely to lead to more than a pause in tensions between the US and China. While Pres. Trump sounded some conciliatory notes prior to flying to Japan, he has since dampened expectations by insisting that if the meeting produces anything less than significant progress toward a trade deal he would not take off the table his pending 10 to 25% tariff threat on the remaining USD 300 bn of annual US imports from China, nor would he rollback any of the existing Section 301 tariffs on US imports of Chinese goods.

Meanwhile, Pres. Xi has warned against "bullying actions" and is reported to have prepared a set of terms that the Chinese expect would be preconditions for resuming trade talks. This set of demands likely includes:

- Elimination of all US Section 301 tariffs on imports from China;
- Ending the US ban on Huawei technology sales in the American market, an issue that the White House has both tried to keep separate from the trade talks and which Pres. Trump has said several times could be bundled into a trade deal;
- An agreement to maintain Chinese commitments to buy additional US goods to the USD 200 bn annual level Presidents Trump and Xi agreed in December 2018, which the Chinese view as consistent with their domestic demand;
- Greater flows of US high-tech exports to China and reduced US pressure to limit technology transfers and reform industrial policy under a so-called "balanced" deal; and
- Easier Chinese access to US visas and business approvals.

In return for some movement from the US on these demands, China could offer to walk back threats to limit or ban exports to the US of rare earth metals and stay any intentions to put US companies on its "unreliable entity" list.

The harder rhetoric going into Osaka speaks to the divergent expectations both leaders have set for the US-China relationship: Pres. Trump needs to demonstrate that he's extracting game-changing concessions from China that

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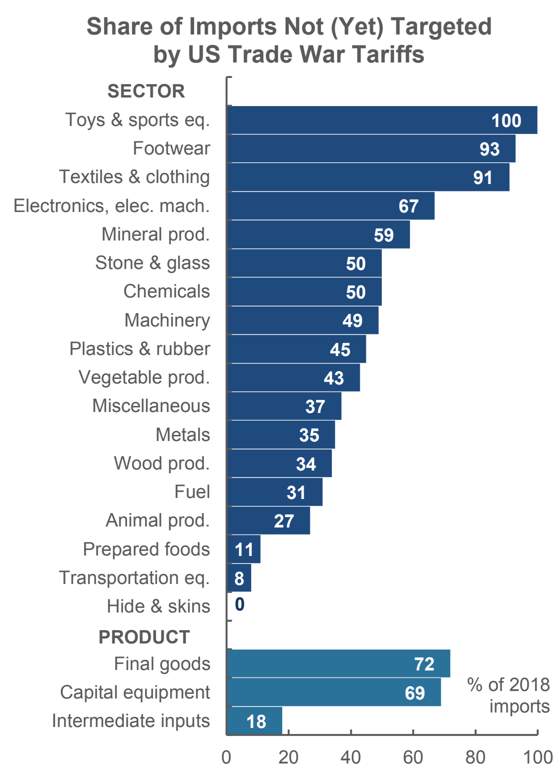
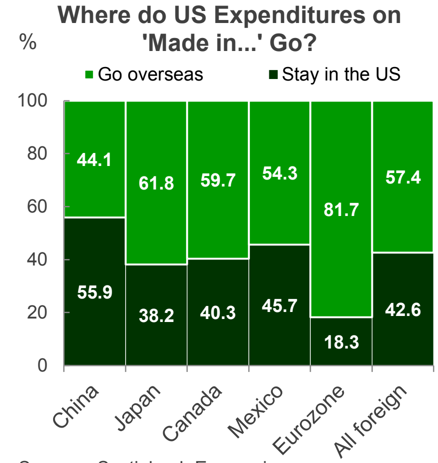
Chart 1



Sources: Scotiabank Economics, PIIE.

reflect elements of the near-deal that was dropped in April, while Pres. Xi has to create the impression that any deal returns Sino-American economic relations to their pre-2018 status. In principle, this leaves only a small Overton window of acceptable outcomes in which to reach a compromise agreement at this meeting since both Trump and Xi have opened themselves to much domestic criticism on any deal. Despite US Treasury Secretary Mnuchin's recitation this week that a deal is "90 percent done", in trade deals, 90% done says very little. As the recent USMCA negotiations imply, no trade deal is ever really partially done: nothing is agreed until everything is agreed. The one virtue of strong rhetoric, though, is that it can and eventually has been bent in the past to market minor compromises as major achievements.

Chart 2



Sources: Scotiabank Economics, Federal Reserve Bank of San Francisco.

We don't expect any breakthrough deal out of Osaka, but we do anticipate that Presidents Trump and Xi will at least make vague promises to continue talks in the coming weeks in order to put a pause on tensions and to reassure markets. Deadlines for talks either to start or to conclude are likely to be avoided since we doubt that this White House wants to proceed with additional Section 301 tariffs on Chinese goods following the multiple blown deadlines on its second tranche of these tariffs earlier this year. Moreover, it's not clear that the existing Section 301 tariffs are working given mounting evidence of Chinese transhipments through third countries such as Vietnam, reductions in Chinese tariffs on other countries' goods to diversify its trade ties, and research that finds that the burden of the White House's existing tariffs is falling squarely on US companies and consumers.

Regardless of any progress the US and China make in Osaka, economic and political incentives remain strongly aligned against President Trump making good on his threat to levy more Section 301 tariffs on Chinese imports. The Section 301 tariffs the White House has imposed on Chinese imports have so far been carefully designed to avoid hitting major consumer goods, as chart 1 shows. A move to impose tariffs on US imports of Chinese toys, sports equipment, shoes, clothing, and electronics just as retailers are stocking up for the 2019 Christmas season would impose an obvious and immediate penalty on US households—over USD 2,000 per year in most estimates—just as the 2020 US election season shifts into high gear. Further Section 301 tariffs on imports from China would also have a disproportionate negative impact on the wider US economy beyond personal pocketbooks given the already-high degree of supply chain integration between the US and China. As chart 2 shows, more than half of every US dollar spent on Chinese imports boomerangs bank to American interests or stays in the US from the outset. While rationality hasn't underpinned the Trump Administration's trade policy, political self-interest remains at the core of this White House's agenda and a tanking economy has never been a positive for gaining re-election.

Chart 2 raises some concerns for the European Union and Japan, who are in the midst of a six-month stay on possible US tariffs on auto imports. When the White House's attention eventually shifts back to this issue, chart 2's data could prove to be unfortunate ammunition in Pres. Trump's war of words with Brussels and Tokyo.

CANADA: CLOSE TO CHINA IN THE ALPHABET ONLY

It appears that Canada's delegation to the G20 Summit has failed to secure any kind of major bilateral meeting with Chinese officials in Osaka and an easing of our bilateral trade tensions is unlikely coming out of the G20 Summit. Canada's opportunity to engage China may be limited to the reported "positive interactions" that have taken place between Prime Minister Trudeau and Pres. Xi. These appear to have been facilitated solely by the fact that Canada and China are seated beside each other in alphabetical order in the Summit's meetings. This implies that we shouldn't expect any movement in Osaka on the newly imposed ban on Canadian meat imports, which amounted to about CAD 600 mn out of a total CAD 27 bn in Canadian exports to China in 2018, nor on pre-existing restrictions on Canadian canola.

Canadian agricultural exports to China were up 60% over the combined 2017 and 2018 period owing to the diversion of Chinese demand away from the US, but these gains are set to fade. While other Asian markets, including Japan, that have been newly opened under CPTTP will offer opportunities to absorb goods that would otherwise be headed for China, agricultural exports will likely exert a drag on Canadian growth in 2019.

WTO: DON'T HOLD YOUR BREATH

Japanese officials have contended that G20 members have reached agreement on the "importance" of WTO reform, but others have indicated that no consensus has been achieved on how such reform should be structured or executed. In early-June, G20 finance ministers and central bank governors are said to have dropped from their communiqué a draft clause that would "recognize the pressing need to resolve trade tensions", but they did offer some rote support for the rules-based multilateral trading system. Osaka is unlikely to produce anything stronger from the G20 heads of government, despite the fact that end-2018 and early-2019 marked the first time that global trade volumes have contracted on a year-on-year basis since the 2008 financial crisis (chart 3).

Chart 3

Sources: Scotiabank Economics, Netherlands Bureau for Economic Policy Analysis.