CEI Centre for International Economy

# GLOBAL REPORT

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# WORLD

## CHINA-U.S. AGREEMENT: A TRADE DISTORTING "PHASE ONE"

On 15 January, the U.S. and China signed the phase one of the agreement intended to end the trade tensions started almost two years ago. Even though the agreement states that both parts assume obligations, in practice it seems to be more about Chinese concessions to demands of the U.S. This includes modifications in the Chinese trade policy in different areas and a commitment on the part of this country to increase the purchases from the U.S. With respect to the bilateral import tariffs, the changes announced in December are in force (see CEI Global Report January 2020).

In the agricultural chapter, China is committed to improving the rules and practices on biotechnological products, sanitary measures, the administration of tariff-rate quotas and the domestic aid. In fact, this implies complying with the WTO standards though with negotiations outside said body.

Among the most conflicting issues, China commits itself to improving protection of intellectual property rights, avoiding forced technology transfer practices to achieve market access –one of the most criticised topics by the U.S.– and to reducing the hurdles to financial service provision. In terms of exchange rate policy, China agrees to avoid the use of "competitive devaluations" and offer timely information regarding balance of payments and foreign exchange policy. Due to this commitment, the Department of the Treasury eliminated China from the monitoring list of countries that incur in "currency manipulation practices".

Besides, in a clear example of administered trade, the agreement includes a chapter on trade expansion by which China commits itself to increasing the imports of goods and services from the U.S. in no less than 200 billion dollars between 2020 –38%– and 2021 –62%–, with respect to what was purchased in 2017, which amounted to 154 billion dollars. The greatest commitment involves industrial manufactures, followed by energy products, services and agricultural goods. As long as this increase in imports is complied with, a trade deviation at the expense of other Chinese suppliers would be seen, thus giving rise to distortions in world markets. On the other hand, this agreement further weakens the system of multilateral rules established by the WTO.

President Trump announced that the negotiation corresponding to phase two of the agreement will shortly be started and that import tariffs will still be one of the negotiating tools. Two core questions of this second phase will be the Chinese industrial subsidies and the actions of its state owned enterprises.

## THE U.S REACTIVATES TENSIONS OVER STEEL AND ALUMINIUM

While the agreement with China defused the main source of trade tension, the U.S. reactivated the trade barriers to aluminium and steel and renewed the threat against the EU. On 24 January, President Trump issued a Proclamation by which he extends to certain products elaborated with aluminium and steel, the additional 10% and 25% tariff that he had imposed in January 2018 to basic products of those two metals, respectively.

The reason behind this was the growth in imports of these products as a way to avoid the tariff on the least elaborated goods, which could damage local production of raw materials. Like in basic products, imports of manufactures of aluminium originated in Argentina, Australia, Canada and Mexico and those of steel from Argentina, Australia, Brazil, Canada South Korea and Mexico are exempt from these new additional tariffs. In case of an increase in the imports from these countries, the U.S. will be able to apply an additional tariff, adopt quotas or negotiate voluntary agreements.

**UNEQUAL GROWTH PROSPECTS FOR THE WORLD ECONOMIES**

After a two-year downturn of the global economic activity, the World Bank foresees a slight recovery of 2.5% in 2020. According to the January Global Economic Prospects, emerging and developing countries would be the world economy engine, which would turn from growing 3.5% in 2019 to 4.1% in 2020, while the advanced economies would grow less –1.6% in 2019 and 1.4% in 2020. In Latin America, Brazil would almost double its growth rate and Argentina would still be in recession. The report also maps an increase in global trade for 2020, assuming global tensions are not deepened.

The predictions made by the IMF in its January issue of the World Economic Outlook are similar. As risk factors to be taken into account, the report points at the progress of the trade tensions between the U.S. and China, the Brexit, and other geopolitical tensions, especially that taking place between the U.S. and Iran.

Within this context, the International Labour Organization considers that the rate of growth of low income countries limits the likelihood of poverty reduction and improvement of labour conditions: 61% of the labour force is unemployed or underemployed and 19% is below the poverty line.

# EUROPE

**THE POST-BREXIT “TRANSITION PERIOD” BEGINS**

On 31 January at 00:00 AM Central European Time, the United Kingdom formally exited the EU. After this, the so-called “transition period” started, during which no modifications in any aspect of the citizens’ lives or in the economic relations between both parties will be introduced, except for the fact that the United Kingdom will not be able to take part in decision making or preserve representations in the bodies and missions within the EU (see Brexit in the spotlight).

A few hours after this period started, the first conflicts regarding a free trade agreement with the EU were already recorded: the European bloc expects the United Kingdom to assume the European standards in matters of labour rights, the environment and state aid –otherwise, its companies would have competitive advantages–, at the same time that the Prime Minister Boris Johnson emphatically rejected said possibility.

The Bundesbank and the European Commission demand a “regulatory convergence” so that the British territory does not become a territory with fiscal incentives.

## SHARP SLOWDOWN IN GERMANY’S ECONOMIC GROWTH

The German growth decelerated significantly in 2019: the strongest economy of the EU grew 0.6 % in 2019, a figure that strongly contrasts the 1.5% of 2018 and the 2.5% of 2017. According to the report published by the National Office of Statistics, domestic consumption was the main engine of economic growth, which even resisted the negative contribution originated by the deficit in the trade balance.

## MACRON AND TRUMP AGREE ON A “DIGITAL TRUCE”

In January, President Emmanuel Macron agreed with President Donald Trump to delay the collection of the digital services tax (DST) in France until 2021. In exchange for this concession, the U.S. will not implement its previously announced retaliation in the form of import tariffs of up to 100% on French goods for an amount equivalent to 2.4 billion dollars. It is worth remembering that in 2019 the U.S. started an investigation under section 301 of its trade law to analyse the French DST arguing that it discriminatorily charges US companies (see CEI Global Report, August 2019).

The so-called “Google Rate” or “GAFA Rate”, (since it charges, among other companies, Google, Amazon, Facebook and Apple) is also under analysis in other European countries like Spain, Italy and the United Kingdom. In that respect, President Trump also warned in January that he will impose tariffs on the imports of cars from the United Kingdom if the latter does not desist from its attempt to apply said tax. In spite of these warnings, the representatives of the European countries reiterated their intent to apply the DST next year if the OECD does not define a general policy on the matter.

The digital services tax was one of the most discussed topics at the World Economic Forum in January and it is a core topic of analysis at the OECD. The debate intermingles with the attempts of big companies to avoid the payment of taxes when setting up their companies in countries with a low fiscal burden and the need to redesign a global taxation system that adapts itself to the current forms of production, where value added generation does not circumscribe to the origin of the parent company. It is expected that the OECD hands out a document in that respect in coming weeks which allows its discussion at the G20 meeting in June.

It is also worth emphasizing that the EU –which in 2019 tried unsuccessfully to implement a DST at a community level, due to opposition of countries like Ireland and Luxembourg–, also has a strong interest in advancing in said agenda: Margrethe Vestager, the new Commissioner of the Competition, has been chosen as the key figure to progress with that objective (see CEI Global Report, October 2019).

# SOUTH AND CENTRAL AMERICA

## ECUADOR AND MEXICO PREPARE AGREEMENT FOR PRODUCTIVE INTEGRATION

Ecuador and Mexico started the First Round of Negotiations for an Agreement for Productive Integration. So far, seven disciplines will be negotiated: market access, rules of origin, sanitary and phytosanitary measures, trade facilitation, intellectual property, good regulatory practices and competition policy.

The Agreement is not only expected to set up a legal framework that eases greater exchange in goods and services and attraction of investment, but which also quickens access of Ecuador to the Pacific Alliance. At present, both countries have a Partial Agreement that only applies to the trade in goods and for a limited number of products.

## URUGUAY AND BRAZIL CONQUER NEW MARKETS

Uruguay obtained the Halal certification to export bovine and ovine meat and giblets to Saudi Arabia, after several audits to its meat processing plants and to the Uruguayan system of sanitary control. In 2018, Uruguay had a share of 3.3% and 0.9% of the global exports of bovine and ovine meat and giblets, respectively, while Saudi Arabia demanded 0.9% and 2.1% of said products.

On the other hand, Brazil will begin to export sesame seeds to India (main global exporter of that product and the seventh importer) in exchange for importing maize for seeding from the Asian country. Currently, this product's main suppliers to Brazil are the U.S. (73%) and Argentina (27%).

## BOLIVIA ELIMINATES EXPORT CONTROLS

Bolivia's interim government, led by Jeanine Áñez, passed a Decree through which it overrode several measures limiting the exports of national agroindustrial products, by means of quotas or by obtaining a certificate of domestic supply adequacy and fair price. The products affected included sunflower oil, soya beans and soybean meal.

These measures, implemented in 2008, sought to guarantee domestic supply and avoid speculation in prices. In turn, Áñez's government would monitor the volume and prices in the domestic market.

## BRAZIL WITHDRAWS FROM THE CELAC

The Brazilian Minister of Foreign Affairs, Ernesto Araújo, announced Brazil's withdrawal from the Community of Latin American and Caribbean States (Celac), which it was part of since 2010 and which had been created as an initiative of former President Lula da Silva. As one of the reasons behind this, Araújo highlights his disagreement with the participation of governments that his government considers non-democratic.

This political forum is made up of other 32 countries from the region and until Brazil's withdrawal, it accounted for 8.4% of the population and 6.5% of global GDP

# NORTH AMERICA

**THE U.S. FINISHES THE USMCA RATIFICATION PROCESS**

On 16 January, the U.S. Senate approved the Agreement between the United States, Mexico, and Canada (USMCA), by a vote of 89 to 10. Almost two weeks later, on 29 February, President Donald Trump signed into law the Agreement.

Canada is the only one of the three trade partners which has not yet ratified the USMCA, though it started its legislative process in the last week of January. This procedure demands three readings in the House of Commons, followed by three readings in the Senate to be finally submitted for Royal Consent. The approval is expected to take place during the first quarter of the year.

The Agreement will come into effect in the third month after the last trading partner notifies that it has concluded with the domestic procedures for approval. Once this happens, the USMCA will replace the obligations of the parties under the North American Free Trade Agreement (NAFTA).

**UNEVEN GROWTH OF NORTH AMERICAN COUNTRIES IN 2019**

The U.S. ranked as the North American country with the best economic performance in 2019. According to the latest estimates published by the Department of Commerce of the U.S., the economy grew 2.3% in 2019. This figure shows a deceleration with respect to the previous year, when the economy grew 2.9%, standing below the 3% growth objective set by the White House.

In turn, the Mexican GDP shrank 0.1% in 2019, hitting its worst record in a decade: according to analysts this is the price that the government of President Andrés Manuel López Obrador has to pay for his agenda of economic reforms. It is worth remembering that the Mexican economy grew 2.1% in 2018. On the other hand, the National Bank of Canada reported that the country's real GDP grew 0.1% in November 2019 and it estimated the year would be closed at 1.6%.

Considering the outlooks, the U.S. Congressional Budget Office estimates a 2.2% growth of GDP for 2020, while the National Bank of Canada anticipates 1.9% for the U.S and 1.8% for Canada, which would indicate a convergence between the growth rates of both countries for next year.

# ASIA AND AFRICA

**NEW TREND? CHINA GREW 6.1% IN 2019**

After years of "Chinese rates" of growth in two digits, the Asian country has not surpassed the 7% annual growth rate since 2015. This is confirmed by the last 2019 data published: the Chinese economy grew 6.1% and met the government's goal set between the 6% to 6.5% range. The figure was lower than the 6.6% recorded in 2018.

In its January outlook, the IMF (see World) observed that economic growth in China will decrease at a slower pace in coming years (6.0% in 2020 and 5.8% in 2021). In addition, the report points out that even though the "phase one" of the agreement between China and the United States will partially reduce trade tensions, the unmet controversies regarding the economic relations between both countries will still hamper economic activity.

**CORONAVIRUS ALREADY AFFECTS BOTH CHINESE AND INTERNATIONAL ECONOMIES**

By mid-December 2019, the Chinese city of Wuhan recorded an outbreak of pneumonia caused by the novel coronavirus (COVID-19), which has caused hundreds of deaths in the Asian country. Although the Chinese authorities have intensified the preventive measures to limit its propagation, the virus has already spread to more than ten countries, among them the U.S., France and Australia.

The impact on the Chinese economy and its repercussions at international level have begun to be felt. Due to an abrupt reduction of the demand in the Asian nation –which jeopardizes the purchase commitments recently undertaken through the agreement with the U.S.–, the international grains market in Chicago has recorded significant falls in the price of soyabean, maize, wheat, vegetable oils and petrol.

In order to face the aftermath on the Chinese economy –worsened by the backlash on the price of the yuan and the stock markets– the Chinese central bank (PBOC) announced in January a 175 billion dollar injection to the financial system.

**SOUTHEAST ASIA LEADS FDI INFLOWS INTO THE REGION**

According to UNCTAD's 2020 Global Investment Trends Monitor, Southeast Asia retained its leading position in Asian FDI growth (19% in 2019). Singapore ranked first as investment receptor, with a 42% rise driven by investment in the informations and communications sector. Indonesia was ranked second, with a 12% rise in the flows intended for the wholesale and retail sectors, and to manufactures. Outside said region, India's performance (+16%) stands out in matters of investment reception, while the inflows directed to Bangladesh and Pakistan contracted 6% and 20%, respectively. The FDI directed to the Hong Kong Special Administrative Region of China and South Korea also decreased (48% y 46%, respectively)

The report points out that global FDI remained stable in 2019 in spite of a weak macroeconomic performance and the uncertainty generated by the trade tensions.

**SUBSTANTIAL GROWTH OF DEALS UNDER THE OBOR INITIATIVE**

In the first 11 months of 2019, the Chinese companies signed contracts structured under the OBOR (One Belt, One Road) initiative worth nearly 128 billion dollars, representing a 41.2% increase with respect to the same period in 2018, according to the Ministry of Commerce of China (MOFCOM). This increase of new contracts reverts the setback recorded in 2018, after the projects carried out in Malaysia, Sri Lanka and Pakistan were criticized by local civil servants for their high costs.

## CONTROVERSY OVER THE IMPLEMENTATION OF THE ECO

The creation of the “Eco as a new currency in the West African countries replacing the historical CFA franc has been giving rise to differences between the countries in the region with regards to the terms set for its implementation. The nations belonging to the West African Economic and Monetary Union (WAEMU) announced, together with France, the institution of the Eco as the new currency for 2020; in turn, the English speaking countries grouped in the Economic Community of West African States (ECOWAS) pointed that this change should be made in a slower fashion and that the new currency should encompass the whole region, that is to say, the seven remaining ECOWAS countries, so that it does not represent a simple replacement of the CFA franc.

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International Trade and Worship
Argentina

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