RECENT TRADE TENSIONS AND THEIR IMPLICATIONS

Since the beginning of 2018, the exacerbation of trade tensions has led to an increase in tariffs, which has affected just over 2.5 per cent of global trade so far. This increase has been more marked in the United States, where it has concerned 11.2 per cent of the country's total imports. Some of the economies hit by the new duties, including the European Union (EU) and China, have reacted by introducing their own tariffs on imports from the US market, although spread out over time and on a more limited range of goods.

Between June and September 2018, following a series of surveys on China's commercial behaviour carried out by the US Trade Representative, the Trump administration imposed higher duties on imports from China, worth $250 billion and equal to about half the total purchases of Chinese goods. The Chinese authorities reacted by announcing new tariffs on a smaller amount of imports from the United States, worth about $60 billion. Under the threat of a further tightening of protectionist policies, the two countries have suspended the introduction of new tariffs since the end of November and started a broader negotiation on trade relations. After a number of bilateral meetings, the US decided that there had been insufficient progress in the negotiations. At the beginning of May this year, tensions therefore resurfaced between the two countries, leading to a further rise in duties on flows of goods that were already affected.

In the first three quarters of 2018, international trade recorded strong growth, though lower than in 2017, followed by a downturn in the fourth quarter, which continued into the early months of 2019. Almost in conjunction with the introduction of the new duties, Chinese sales to the United States fell, following the increase in the previous months due to US operators attempting to bring forward purchases in anticipation of the introduction of the new tariff regime.[1] The impact of the protectionist policies, which affect the relative price of imports too, was almost entirely passed through to the final prices of the goods concerned, thereby transferring the greater costs caused by trade tensions to US consumers. This led to an overall estimated reduction of around $20 billion in the disposable income of US households.[2] Imposing tariffs might not favour the reshoring of production processes hoped for by the Trump administration, thus limiting the impact on the US labour market. This is ascribable to the tendency of firms to consider outsourcing as an alternative to automating routine activities that make little use of human capital.[3]

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[1] V. Gunnella and L. Quaglietti, '*The economic implications of rising protectionism: a euro-area and global perspective*', ECB, *Economic Bulletin*, 3, 2019, 43-67.

[2] M. Amiti, S.J. Redding and D.E. Weinstein, 'The impact of the 2018 trade war on U.S. prices and welfare', CEPR Discussion Paper, 13564, 2019.

[3] '*International trade and risks of protectionism*', testimony by G. Parigi, the Head of the International Relations and Economics Directorate of the Bank of Italy, Senate of the Republic, Rome, 25 October 2018 (only in Italian).

The dynamics of world trade have also been affected by the tightening of financial conditions and the increase in uncertainty. Between early June, when the tensions between the United States and China resulted in the application of tariffs, and the end of November, when the presidents of the two countries agreed on a trade truce, the MSCI World Index fell by 3.5 per cent, while that relating to the firms most exposed to China decreased by almost 15 per cent (see the box 'Trade tensions, uncertainty and economic activity', *Economic Bulletin*, 4, 2018).

According to the International Monetary Fund's estimates in October's World Economic Outlook, in 2019 the downturn in world economic activity attributable to the direct effect of tariffs will be slightly more than 0.1 percentage points and the US and Chinese economies will be the hardest hit. Nevertheless, should trade tensions intensify, the consequences would be even more serious: in 2019, world GDP would decline by almost 1.0 per cent compared with a scenario with no tariff increases; GDP in the US and in China would decrease even more (by 1.0 and 1.6 per cent respectively), but the contraction in the euro area would be modest (0.3 per cent). Within the euro area, the German economy would be particularly affected, being more exposed to international trade, as would the Italian economy, which is closely integrated into regional value chains. The models used for these simulations are unsuited for providing an assessment of the impact of profound and structural changes in the set-up for trade and production organization – in the form of sectoral and geographical shifts – such as those that might occur in the event of a more marked raising of tariff barriers: the figures indicated above could therefore underestimate the impact of a significant tightening of protectionist policies.

Quantifying the indirect effects of such policies is made more complex by the fragmentation of production processes on a global scale, which has made strong productivity growth possible in recent years.[4] The presence of value chains operating in more than one customs regime tends to amplify the negative effects on world trade of introducing new duties. With reference to the tariff barriers introduced by the United States, flows of goods worth about $165 billion have already been rerouted to avoid tariffs. Reorganizing the current supply relationships could be very costly for participating firms.

[4] S. Formai and F. Vergara Caffarelli, '*Quantifying the productivity effects of global sourcing*', Banca d'Italia, Temi di Discussione (Working Papers), 1075, 2016.