Manulife Investment Management

Market Note

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On 15 January 2020, the United States and China signed the long-awaited phase-one trade deal[1]. The agreement, which addresses issues ranging from Chinese imports of US goods to currency, came as no surprise to the market, as both sides had been publicly discussing the pact since the middle of December. In this market note, Sue Trinh, Senior Macro Strategist, Manulife Investment Management, assesses the significant aspects of the deal and notes that the real test will be in implementing the details of the agreement and setting the agenda for the next phase of talks.

US-China phase-one trade deal: the devil is in the details

The signing of the phase-one US-China trade deal came as no surprise to investors. Although the agreement contains important steps on market access, intellectual property rights, and currency, many of these had already been announced or implemented before 15 January. Overall, we believe that China will continue to deliver on any commitments that overlap with its self-interest, which ultimately raises the stakes when trying to enforce the deal in areas where it doesn't comply. As always, the devil is in the detail.

Looking at the substance of the agreement, China has agreed to increase purchases and imports of US goods and services by at least US$200 billion in 2020 and 2021. These include agricultural, manufacturing, and energy products[2]. Overall, we believe that the agreement on purchase levels seems unrealistic, but China could meet it if the government diverts its current import demand away from other trade partners to the US. Such a move would mean that China's total imports remain unchanged and global growth would receive no boost. We also note that a larger share of the proposed purchases is slated for 2021 than 2020. This schedule gives China the flexibility to deal with a potentially different administration in the US after the upcoming November elections. China also has several mitigating clauses for purchases, such as slower domestic growth. Furthermore, the US must make goods available for export, which could become an issue with existing export restrictions.

Regarding currency, the agreement contains almost nothing new. China has agreed to provide data that it already discloses through foreign-currency reserves or balance-of-payment data. The other provisions are mostly a reiteration of existing Chinese commitments to the International Monetary Fund and G-20.

Finally, the agreement may be most notable for the issues that it doesn't address. The core of the US-China economic dispute revolves around several themes, such as tariffs, technology transfer, and Chinese government subsidies, none of which are mentioned in the text. President Trump has stated that a potential phase-two deal and tariff rollback can wait until after the presidential elections in November[3]. However, as the phase-one deal gives the US the unilateral right to punish China if it fails to deliver on its pledges, tensions could escalate at any time.

From a market perspective, the Chinese renminbi has been a principal beneficiary of the optimism leading up to the deal. Since the contours of the agreement were announced in mid-December last year, the renminbi (both onshore and offshore) has been one of the best-performing emerging-market currencies.

Having said that, we believe that weaker Chinese growth and increased non-trade barriers should

[1] Office of the United States Trade Representative: Economic and Trade Agreement between the United States of America and the People's Republic of China, Phase One, 15 January 2020.
[2] The benchmark for purchase amounts will be 2017. In 2017, China bought US$130 billion in goods and US$56 billion in services, 15 January 2020, Wall Street Journal.

[3] Reuters: "Trump says he may wait to finish Phase 2 China trade deal until after November, "10 January 2020.

lead to another bout of renminbi depreciation. A breakdown in phase-two talks would likely accelerate that trend.