Escalating Global Uncertainties: The Role of Trade Policy

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Economic Policy Uncertainty, South Korea, Jan. 1997 to Feb. 2019

Policy Uncertainty Index

Sources: Baker, Bloom and Davis (2016) and PolicyUncertainty.com based on six leading South Korean newspapers. The series is normalized to mean 100 from 1995 to 2014.
Trade Policy and Global Uncertainties

1. Trade policy became a major source of economic uncertainty in 2018.

   • A sharp break from the historical pattern.

3. But the trade policy impact on U.S. domestic investment was still small.
   • Why?

5. The U.S.-China conflict over trade and commercial policies is harming China much more than the U.S.

6. China’s case illustrates a broader point: The shift in U.S. trade policy under the Trump Administration is more harmful and worrisome for many of its trading partners than for the U.S. itself.

7. Looking ahead...
Trade Policy Matters Became a Leading Source of Economic Uncertainty in 2018

Percentage of Articles about Economic Policy Uncertainty in Leading National Newspapers that Discuss Trade Policy Matters

<table>
<thead>
<tr>
<th>Time Period</th>
<th>United States</th>
<th>Japan</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>1987-2015</td>
<td>4</td>
<td>8</td>
<td>16</td>
</tr>
<tr>
<td>2000-2015</td>
<td>2</td>
<td>7</td>
<td>20</td>
</tr>
<tr>
<td>NAFTA: January 1992 to June 1995</td>
<td>11</td>
<td>11</td>
<td>10</td>
</tr>
<tr>
<td>China WTO Accession: Jan 2000 to Dec 2002</td>
<td>3</td>
<td>5</td>
<td>36</td>
</tr>
<tr>
<td>November 2016 to December 2018</td>
<td>9</td>
<td>20</td>
<td>39</td>
</tr>
<tr>
<td>March-December 2018</td>
<td>15</td>
<td>27</td>
<td>48</td>
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</tbody>
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Trade Policy News Jolted the U.S. Stock Market in 2018

Consider all daily jumps in the U.S. stock market greater than 2.5%, up or down, since 1900. Classify the reason for the jump based on human readings of next-day accounts in the *Wall Street Journal*.

|                | Number of Daily Jumps Greater than |2.5%| | Number Attributed to Trade Policy News |
|----------------|-----------------------------------|-----| | --------------------------------------|
| 1900 - 2017    | 1,103                             |     | 7                                      |
| During 2018    | 9                                 |     | 3                                      |

Source: Baker, Bloom, Davis and Sammon (2019)
Percent of Articles about Equity Market Volatility in Leading U.S. Newspapers that Discuss Trade Policy Matters, 1985 to 2018

NAFTA Negotiations, Agreement, Ratification and Introduction; January 1992 to June 1995 Mean: 6.7%

Tariff Hikes, Trade Tensions, March-December 2018; Mean: 26.0%

Trump Takes Office, Pulls out of TPP, January 2017

Brexit Referendum, June 2016

1985-2015 Mean: 2.7%

Trade Policy Effects on Investments

- **Wait-and-see behavior**: Highly elevated trade policy uncertainty can prompt investment cutbacks and delays.

- **Less confidence, more anxiety**: It can also reduce risk tolerance and expected future demand → lower asset prices, higher credit spreads → negative impact on investment.

- **Adaptive responses**: Persistently higher tariffs and erosion of rules-based trading system → retreat from global supply chains and distribution networks → a re-direction of investment and input sourcing → higher costs and lower productivity + near-term & medium-term adjustment costs.
Estimated Impact of Tariff Hikes and Trade Policy Tensions On Gross Capital Investment by U.S. Businesses in 2018

<table>
<thead>
<tr>
<th></th>
<th>(1) Percentage Impact on Capital Expenditures</th>
<th>(2) Impact on 2018 Capital Spending ($ billions)</th>
<th>(3) Number of Survey Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Sector</td>
<td>-1.2%</td>
<td>- $32.5</td>
<td>337</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>-4.2%</td>
<td>- $22.0</td>
<td>95</td>
</tr>
</tbody>
</table>

Small relative to a $21 trillion economy.

Source: Calculations in Altig et al. (2019) using firm-level responses in the January 2019 Survey of Business Uncertainty, conducted by the Federal Reserve Bank of Atlanta, the Chicago Booth School of Business and Stanford University.
Why Such Small Effects on U.S. Domestic Investment?

Many U.S.-listed firms have major commercial interests abroad:
- Foreign production facilities that export to the US
- Supply chains that run through China
- Brand values and distribution networks in foreign economies

Tariffs and trade-war concerns put these commercial interests at risk and reduce their value. That, in turn, lowers the equity value of the company on the US stock market, even when it has little impact on the company’s US domestic operations.

Our survey evidence may not capture indirect effects of trade policy: For example, when US tariff hikes weaken foreign economies, they also lower demand for US exports. Companies in the survey may attribute these demand declines to overall economic conditions rather than trade-policy developments.
U.S. Equity Market Performance by China Exposure, March 2018 to February 2019

- March 2018 = 100
- US considers further tariffs on $200 bn
- Steel and aluminum tariffs announced
- Source: Bloomberg Finance, Wind Information Co. Database, IMF Staff Calculations.
Trade Policy Uncertainty: China

This chart shows a newspaper-based index of trade policy uncertainty based on the Renmin Daily and the Guangming Daily.

Source: Davis, Liu and Sheng (2019). The index is normalized to 100 from January 2000 to November 2018.
China’s Stock Market Performance in 2018

Main Index = Shanghai Stock Exchange Composite Index

Small Cap Index = China Shenzhen Small Medium Enterprise Composite Index

Source: Bloomberg Finance, Wind Information Co. Database, IMF Staff Calculations.
Two Policy Blows to China’s Economy

A Punch in the Nose: Conflicts with the U.S. over China’s trade and commercial policies reduce China’s attractiveness as global supply chain node and destination for foreign investment.

• Many Chinese policies and practices in this regard are longstanding, genuine concerns. The U.S. is now resolved to press the matter. That resolve is likely to outlast Trump.

Shots to Own Foot: China’s heavy-handed treatment of foreign firms also discourages sales, production, and investment in China by multinational firms.

• Hyundai’s sales and Lotte’s supermarket sales in China fell drastically in the wake of THAAD dispute between South Korea and China.
Why China’s Economy Is More Vulnerable To Trade Policy Shocks and Uncertainty

1. China trades a lot with the United States and the ROW.
2. In recent years, China invested enormously in private capital, public infrastructure, and supply-chain networks that are suited for the prices, technologies, and trading rules that prevailed in the recent (pre-Trump) global environment.
3. FDI into China from rich countries is large and important, partly because it facilitates technological advance in China.
4. Trade policy conflicts have stronger negative effects on investor and business confidence when the underlying economy is slowing or faced with major uncertainties.
Confidence Effects on Investment

Policy uncertainty and disruption effects on investor and business confidence are context dependent.

• Against the backdrop of the Trump Administration’s tilt towards a more growth-friendly regulatory stance, the Tax Cut and Jobs Act of 2017 and strong U.S. macroeconomic performance, recent trade policy developments appear to have had little negative effect on confidence in the United States (at least thus far).

• China offers a contrasting example: Trade policy concerns are highly salient, growth has been slowing, and there are concerns about the soundness of China’s financial system. In the Chinese context, recent trade policy tensions have had material negative effects on investor and business confidence.
Looking Ahead: Trade Policy Tensions to Continue

1. Even with a new U.S.-China trade agreement, tensions between the two countries will persist and occasionally erupt. Why?
   • Implementation and enforcement challenges
   • U.S. now sees China as a strategic rival and threat to the postwar global order
   • Trump likes tariffs and tariff threats, and China is a politically attractive target.

2. President Trump will continue to wield tariffs and tariff threats against other U.S. trading partners.

3. Anti-globalist sentiments look to remain strong for long in several major economies.
   • They bring uncertainty about trade policy and are hard to contain. Brexit is the leading case in point.


