CIO | VIEW
Macro Perspectives

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DWS

G20 SUMMIT: NO BIG DEAL, WE GUESS

Expect quick-fix headlines and volatility, but no sustainable progress in trade talks

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IN A NUTSHELL

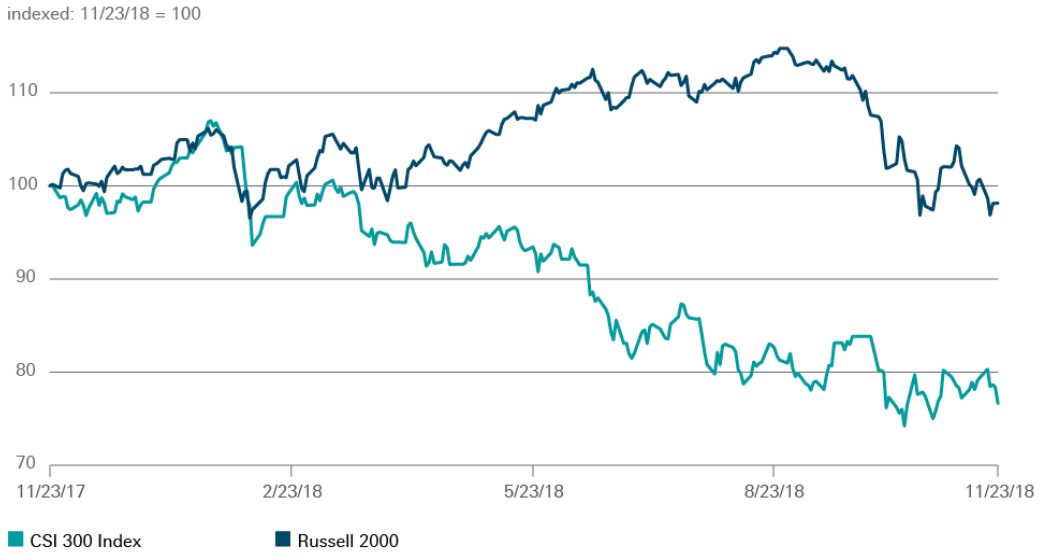
- G20 summit to be one more event for which first market reactions could be misleading, as we expect a quick fix, but no sustainable solution.
- Markets are likely to concentrate on any tariff ceasefire. But we believe tariffs are just one means for the United States to pursue its real goal: to contain China's rise.
- Short-term market reactions are hard to predict. Any kind of quick-fix deal would be a weak basis for a year-end rally in equities.

MARKET EXPECTATIONS FOR THE G20 MEETING ARE HARD TO GRASP

The U.S.-China trade dispute is often cited as one of investors' main worries. At present we are at what might be called the peak of no clarity – and getting some sort of certainty, even if, as with the UK's Brexit, the deal is far from perfect, may give markets a lift.

All eyes certainly will be on the G20 summit in Buenos Aires (November 30 to December 1), and especially on the highly anticipated meeting of the U.S. President, Donald Trump, and China's leader, Xi Jinping. It is widely believed that a 10% U.S. tariff on around 200bn U.S. dollars in Chinese goods will increase to 25% on January 1, 2019 should there be no agreement at the summit. Trump said that the U.S. could also impose tariffs on an additional 267bn dollars of Chinese goods. In autumn's tough markets, Chinese stocks have recently outperformed their U.S. peers, though only after taking a beating earlier. The outcome of the summit is highly uncertain, as is the degree to which markets have priced in disappointment or progress. While we believe investors would be ill-advised to put their faith in a year-end rally based solely on some kind of positive signal from the G20, it might still make them happy for a bit if the can is simply being kicked down the road. However, we believe that if the U.S. is going to trigger tariff increases as announced, it will still weigh on markets.

CHINA TOOK THE HIT EARLIER, NOW THE U.S. IS FOLLOWING SUIT



Source: Thomson Reuters Datastream as of 11/26/18
Footnote: The CSI 300 Index contains the 300 most liquid stocks, which are traded at the Shenzen and Shanghai stock exchanges. The Russell 2000 contains the smaller 2000 stocks of the Russell 3000. Thus, it is a yardstick for those U.S. companies with stronger local alignment.

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SUMMIT OUTCOMES: TRUMP MIGHT PROVIDE A QUICK FIX, BUT THE TENSIONS HAVE DEEP ROOTS

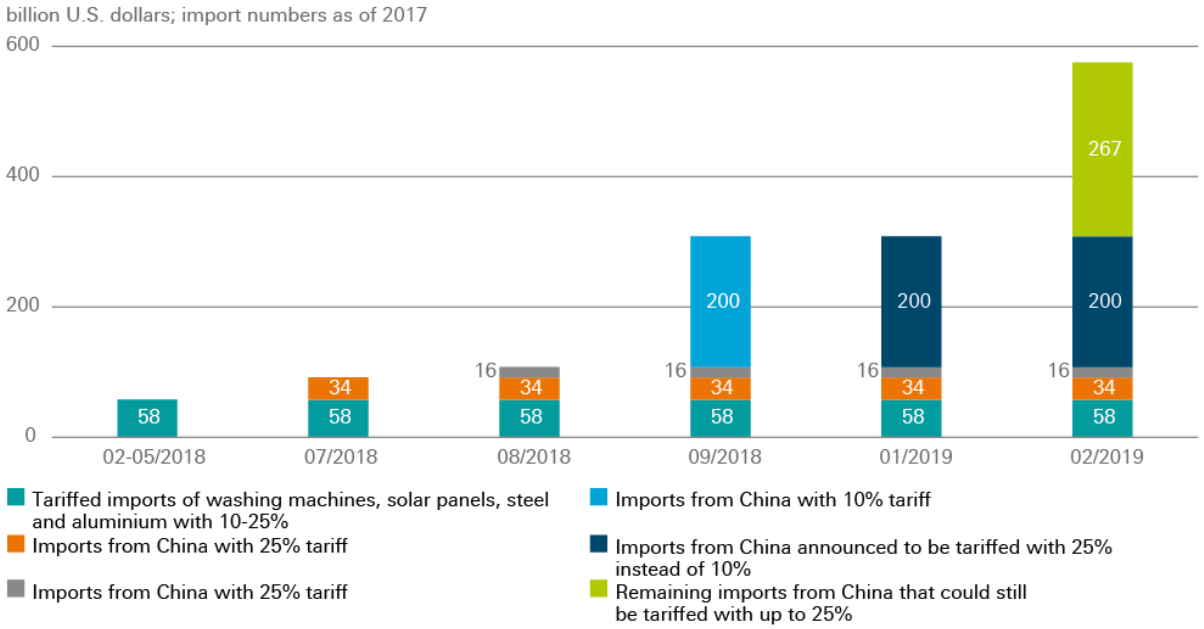
There are good reasons to assume that Trump is aiming for some kind of agreement over the weekend. First, Trump's latest remark on China is that "They very much want to make a deal."[1] Second, the stock market's recent weakness might warn him that investors fear an escalation of the trade dispute. Third, Trump wants to show the world in a high-profile event that he is an accomplished dealmaker. Fourth, with the U.S.-China bilateral deficit set to rise to a record high this year, Trump might feel the urge to deliver some kind of progress. Whether this means a quick deal or an escalation remains an open question, however.

And yet any kind of agreement at the G20 seems unlikely to offer long-term reassurance. We believe the U.S.-China dispute is not just about trade balances. It has a geo-political and strategic dimension. The U.S. fears China's fast ascent on the global economic and political stage. China's growing influence over its neighbors (evident in its Belt and Road Initiative, formerly known as "One Belt One Road") and its aspiration to become a world leader in certain strategically important areas (as laid out in its "Made in China 2025" initiative), are likely to be the real issues for the current administration. This was made surprisingly clear in Vice President Mike Pence's speech at the Hudson Institute in Washington.[2] This idea gains in importance, in light of the Republicans' loss of their majority in the House of Representatives, as Democrats seem to share the view that the U.S. needs more protection from China.

Trump's administration seems split between hardliners who promote more protectionism and isolation and those who have a more pragmatic approach and a focus on foreign business interests. As the Financial Times reported, the willingness of Wall Street leaders to try and build bridges with Beijing has attracted the ire of the more nationalist members of Mr. Trump's inner circle. "When these unpaid foreign agents engage in this kind of so-called diplomacy all they do is weaken this president and his negotiating position," White House adviser and leading China hawk Peter Navarro said this month. "No good can come of this."[3]

Trump himself seems split between the two positions. The U.S. administration's handling of China has been inconsistent, with tariff exemptions granted for some sensitive retail goods, sanctions for single companies that were subsequently revoked, and Trump alternating praise and attacks with regards to Xi.

PUNITIVE U.S. TARIFFS ALREADY INSTALLED IN 2018 AND PLANNED FOR 2019 ON IMPORTED GOODS FROM CHINA



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[1] https://www.cnbc.com/2018/11/16/dow-jumps-after-trump-says-china-wants-to-make-trade-deal.html
[2] https://www.nytimes.com/2018/10/05/world/asia/pence-china-speech-cold-war.html
[3] https://www.ft.com/content/2b72ef10-ed8a-11e8-89c8-d36339d835c0

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THE U.S.-CHINA TENSION WILL OUTLAST TRUMP

Some kind of agreement on trade may come out of the G20 Summit or, we expect, by the end of the first quarter of 2019 at the latest. This would likely prevent the 25% tariffs from being implemented. Meanwhile, any immediate negative impact on the Chinese economy is likely to be mitigated by domestic-stimulus measures from Beijing.

We expect the U.S.-China conflict to outlast Trump, however. The Sino-American[4] dispute has many levels. Most profoundly, the U.S. does not want China to consolidate its geopolitical and economic power. In addition, the U.S. is concerned about intellectual-property theft, China's fostering of certain key technologies and sectors as well as limited market access in China, the unleveled playing field for foreign companies and the role of state-owned enterprises (SOEs). And then, there is the trade deficit. China will not make concessions on all of these levels. According to Elke Speidel-Walz, our chief economist for emerging markets, China's transformation is already necessary simply in order to meet demographic challenges. This is not possible without increasing added value and technological development. A glance at the patent applications alone shows how far China has already come in this respect. In our opinion, it is unlikely that China's progress can be stopped at all because it has long since ceased only to copy, but has already made considerable progress on its journey from "copied and made" towards "innovated and created in China."

SHORT-TERM CONCESSIONS MORE LIKELY THAN LONG-TERM SOLUTIONS

The tensions between the U.S. and China, as Pence has highlighted, reflect the rapid emergence of a major geopolitical rival for the U.S. The two need to learn to live with one another. That will take a long time and is likely to keep haunting markets. Given the array of remedies China can nevertheless offer to the U.S., we might also witness some interim relief rallies in equity markets as a response to temporary de-escalations.

[4] International relationship between the People's Republic of China and the United States of America

GLOSSARY

Belt and Road Initiative
The Belt and Road Initiative is a development strategy adopted by the Chinese government involving infrastructure development and investments in countries in Europe, Asia and Africa.

Brexit
Brexit is a combination of the words "Britain" and "Exit" and describes the exit of the United Kingdom of the European Union.

Democratic Party (Democrats)
The **Democratic Party (Democrats)** is one of the two political parties in the United States. It is generally to the left of its main rival, the Republican Party.

Emerging markets (EM)
Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

G20
The **Group of 20** are the largest industrialized and emerging economies in the world.

Hawk
Hawks are in favor of a restrictive monetary policy.

House of Representatives
The United States **House of Representatives** is a legislative chamber consisting of 435 Representatives, as well as non-voting delegates from Washington, D.C. and U.S. territories. Representatives are elected for two-year terms and each stateâ€™s representation is based on population as measured in the previous Census.

Republicans
The **Republican Party (Republicans)**, also referred to as Grand Old Party (GOP), is one of the two major political parties in the United States. It is generally to the right of its main rival, the Democratic Party.

State-owned enterprise (SOE)
A **state-owned enterprise** is a legal entity that executes commercial activities on behalf of an owner government.

U.S. dollar (USD)
The **U.S. dollar (USD)** is the official currency of the United States and its overseas territories.

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