
**Fung Business Intelligence**
**Global Sourcing**
**16 January 2020**

# China and US sign phase one trade deal

*On Wednesday (15 January), China and the US formally signed an economic and trade agreement, further easing a yearlong trade war between the two countries. Both countries termed it a 'phase one' trade deal and said trade negotiations will continue on remaining issues. We will continue to closely monitor developments in this regard.*

## *China and US sign trade deal easing trade tensions*

Chinese Vice Premier Liu He and US President Donald Trump signed the China-US phase one economic and trade agreement at the White House in Washington on 15 January. The phase one trade deal specifies some structural changes to China's economic and trade regime in the areas of intellectual property, technology transfer, agriculture, financial services, and currency. The trade deal also includes commitments by China to make substantial additional purchases of US goods and services in the coming years. The pact will enter into force 30 days after signing. The full trade agreement could be read here (in English) or here (in Chinese).

The deal signed on 15 January makes no mention of further removal of US tariffs on Chinese goods, although during the negotiation process of the deal the US administration agreed to cancel the proposed 15% additional tariffs on about US$160 billion of Chinese goods scheduled on 15 December last year, and cut the tariff rate to 7.5% from 15% on another US$120 billion of Chinese products, which will be effective on 14 February. However, Trump said that the remaining tariffs on Chinese imports 'will all come off' if the subsequent phases of trade negotiations produce a second agreement. Those talks are expected to begin soon but might not conclude until after the US presidential election in November.

## Chapter-by-chapter details of the phase one agreement

| Chapter | Details |
|---|---|
| 1. Intellectual property | China agreed to step up intellectual property protections, including stricter measures related to trade secrets, pharmaceutical-related intellectual property, geographical indications, trademarks, and enforcement against pirated and counterfeit goods. |
| 2. Technology transfer | China pledged not to force US companies to transfer their technology in exchange for market access. China also commits to refrain from directing or supporting outbound investments aimed at acquiring foreign technology. |
| 3. Trade in food and agricultural products | China agreed to loosen some non-tariff barriers to trade in food and agricultural products, including meat, poultry, seafood, rice, dairy, infant formula, and pet food. The deal also makes it easier for US grain producers to obtain approvals for genetically modified crops in China. |
| 4. Financial services | China agreed to remove trade and investment barriers (such as foreign equity limitations and discriminatory regulatory requirements) against US financial service providers, including those of banking, insurance, securities, and credit rating services. |
| 5. Macroeconomic policies and exchange rate matters and transparency | Both China and the US made certain commitments regarding the operations of their central banks in foreign exchange markets. They pledged not to devalue their currencies to make their exports competitive. |
| 6. Expanding trade | China has committed to importing various US goods and services over the next two years in a total amount that exceeds the 2017 figure by no less than US$200 billion. The two-year total includes US$77.7 billion in additional purchases of manufacturing goods, US$52.4 billion in purchases of energy products, US$32 billion in purchases of agricultural and seafood products, and US$37.9 billion in purchases of services. China's increased imports of US goods and services are expected to continue in 2022 through 2025. |
| 7. Bilateral evaluation and dispute resolution | A framework is set up for officials from the two countries to meet regularly to address alleged violations. If the dispute is not resolved through negotiations, the complaining party can impose punitive measures, such as tariffs, but the party complained against may not adopt a 'counter-response'. |

It should be noted that the US has also made reciprocal promises in areas such as the protection of intellectual property, prevention of forced technology transfer, removal of barriers to agricultural trade, and opening-up of the financial services market, etc.

## *Our take*

1. Even after the trade deal takes effect, US tariffs will still cover about two-thirds of all US imports from China, and Chinese tariffs will still cover over half of all Chinese imports from the US. Thus, one important implication of the phase one deal is that tariffs will become the 'new normal' in the China-US relations.

   Moreover, while the phase one trade deal might have settled some relatively easy disputes such as those over agriculture and currency, several thorniest issues remain outstanding, including the US-alleged 'industrial subsidies' by China. Given that the two countries have deep differences on those issues, we do not expect a smooth negotiation process in subsequent phases of trade talks. Even if the two countries can reach a comprehensive trade agreement in the coming months to end the trade war, which is not likely, broader uncertainties and tensions (such as an escalating technology war) between the two countries are likely to remain for a long time, as the key issue between China and the US is geopolitical rivalry instead of trade, in our view.

2. On the positive side, the China-US phase one agreement has removed the risk of never-ending tariff escalation. Through increasing US exports to China and relaxing restrictions on US companies doing business in China, the two countries could forge closer trade and economic ties in the long term, which would reduce the risk of the US pursuing holistic economic decoupling with China.

   A couple of recent developments in the China-US relations could also be good signs that the two countries are moving towards a more stable relationship. First, China and the US have recently agreed to resume the 'China-US Comprehensive Economic Dialogue'[1], which could be a less confrontational way to get negotiations between China and the US on unresolved, tougher issues back on track. Second, the US has reversed its decision in August to label China a currency manipulator, a rare move by the US to de-escalate tensions with China.

3. There are legitimate concerns about whether the terms of the phase one trade deal will be fully implemented. For example, China pledged to make additional purchases of US goods and services of US$200 billion over two years, from a baseline of US$186 billion in 2017. To fulfill the targets set in the deal, US exports to China would need to go up to US$263 billion in 2020 and US$309 billion in 2021, with the latter representing a 66% jump from the 2017 figure, which some trade experts deem unrealistic.

[1] Under both the Bush and Obama administrations, the Comprehensive Economic Dialogue semi-annual talks were held to resolve economic disputes with China, but the process was abandoned at the start of the Trump administration.

Moreover, the two-and-a-half-page chapter on technology transfer does not require China to change any laws or regulations to fulfill its obligations, which casts doubt on whether China will live up to its promises made.

## *Implications for our sourcing business: We need more diverse and flexible supply chains*

The lingering China-US trade war has caused disruptions in the global trade landscape, bringing fresh challenges and greater unpredictability to our sourcing business. Under such circumstances, production and supply chains now need to be even more diverse, agile, and technology-driven. Businesses with a strong global supplier network and deep relationships with suppliers will be in the best position to meet the new challenges. To navigate the challenging situation, businesses should continue to carry out strategic planning and re-planning for their supply chains, through diversifying sourcing base, nearshoring and onshoring production, and digitizing supply chains.

## FUNG BUSINESS INTELLIGENCE

**Fung Business Intelligence** collects, analyses and interprets global market data on sourcing, supply chains, distribution, retail and technology.

Headquartered in Hong Kong, it leverages unique relationships and information networks to monitor, research and report on these global issues with a particular focus on business trends and developments in China. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments through regular research reports and business publications.

As the knowledge bank and think tank for the Fung Group, a Hong Kong-based multinational corporation, Fung Business Intelligence also provides expertise, advice and consulting services to the Group and its business partners on issues related to doing business in China, ranging from market entry and company structure, to tax, licensing and other regulatory matters.

Fung Business Intelligence was established in the year 2000.

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Fung Holdings (1937) Limited, a privately-held business entity headquartered in Hong Kong, is the major shareholder of the Fung Group of companies, whose core businesses operate across the entire global supply chain for consumer goods including trading, logistics, distribution and retail. The Fung Group comprises 42,000 people working in more than 40 economies worldwide. We have a rich history and heritage in export trading and global supply chain management that dates back to 1906 and traces the story of how Hong Kong and the Pearl River Delta emerged as one of the world's foremost manufacturing and trading regions. We are focused on both creating the Supply Chain of the Future to help brands and retailers navigate the digital economy as well as creating new opportunities, product categories and market expansion for brands on a global scale.

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