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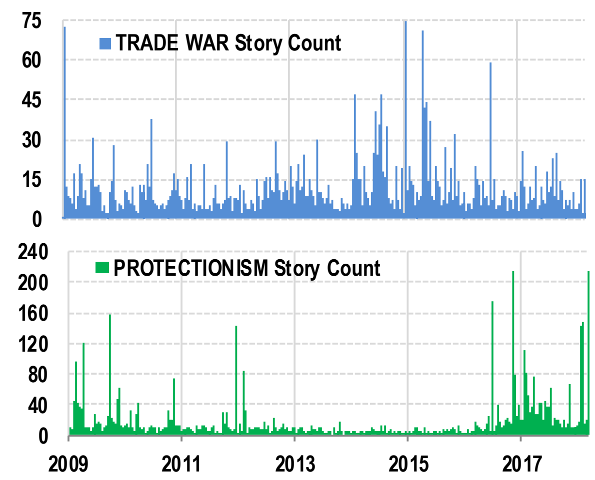
Into the maze of trade disputes

■ The IMF and the OECD have expressed concern about rising trade tensions ■ At the macro level, tariffs create a lose-lose situation but the sector impact varies a lot ■ Beyond the direct economic effect, the impact on inflation and financial markets should also be taken into account ■ The biggest concern is the headwind coming from a structural increase in uncertainty

"*Even though the sun still shines in the global economy, there are more clouds on the horizon. Think of the growing concerns over trade tensions…*" The quote is from Christine Lagarde's contribution to the IMF Blog this week. In presenting its Interim Outlook, the OECD struck a similar chord. Trade concerns come and go. Starting in 2009, the chart shows the daily frequency of Bloomberg stories mentioning 'trade war' or 'protectionism'. It seems there is nothing new under the sun although there is a clear difference since the end of 2016 as far as the use of 'protectionism' is concerned. Looking beyond the media, one observes since the Great Recession a clear trend towards more protectionism. Moreover it is broad-based in terms of countries taking these measures.

BLOOMBERG: DAILY FREQUENCY OF 'TRADE WAR' OR 'PROTECTIONISM'



Source: Bloomberg, BNP Paribas

Turning to tariffs (taxes on imports), the consequences are complex and varied depending whether one looks at the macro, the sector or the micro level. Taking US tariffs on steel products as an example, there is a substitution effect (imports are replaced with US production if it can be expanded and it fits the customer requirements) and a redistribution effect from the exporting countries (lower activity) to US producers (higher activity). There is also a redistibution effect between sectors in the US: local steel producers will see an increase in their production and profits but their clients will have to pay more than before, which weighs on their profitability. They might react by cutting costs (jobs) and investments. The consumer will also see higher prices, which could weigh on household spending. The government on the other hand should benefit from higher revenues due to the import tariffs. Steel exporting countries will suffer from their reduced price competitiveness on the US market. This will result in trade diversion to third countries, and in an oversupply on these markets. This was the recent message of European steel companies: what started as a bilateral problem becomes a multilateral one.

In the US the tariff measures could be inflationary if the switch to domestic suppliers is important, considering that the economy is at full employment. It could also be stagflationary when the supply switch is limited and the tariffs are charged to the end customer. In both cases the Federal Reserve may need to react which may end up weighing on financial markets and indirectly on domestic spending. All this also depends on the economic importance of the imports which are impacted and whether there will be retaliatory measures. The direct macro impact may very well be small but at the sector or company level it can be huge, which in turn can trigger negative indirect effects (e.g. corporate bond or stock market volatility). The biggest concern is quite simply that tariffs end up causing a lasting increase in uncertainty, something which would act as a headwind for the global economy.

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