

Phase one trade deal: stay calm and move on

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- The phrase “China Shall” appeared much more times than the phrase “the United States shall”
- Implementation risk of the phase one trade deal is slightly lower thanks to flexibility of the purchase numbers.
- Intellectual property and technology transfer are two longstanding issues that both countries will continue to work on.
- Think what will happen if there is no deal instead of what China can get out of this deal.
- We think it is a good compromise which will give market more peaceful time. Let’s stay calm and move on.

China and US finally signed the phase one trade deal on 15 January 2020, three months after both sides announced to reach the deal in mid-October 2019. The deal covers six main areas including intellectual property, technology transfer, agriculture, financial services, exchange rate and expanding trade.

On the surface, it looks like that China has made more concessions judging by the number of key words appearing in the deal. After scanning through the trade deal in both English version (released by the USTR) and Chinese version (released by Chinese government), we found out that the key phrase “China shall” has the most hit as compared to the phrase “the United States shall”.

Table 1: number of times the key phrases appeared in the trade deal			
English version		Chinese version	
China shall	97	中国应	84
The parties shall	59	双方应	61
China and the United States shall	2	中国与美国应	1
The United States shall	3	美国应	3
The United States affirms	27	美国确认	28

Source: Phase one trade deal

Lower implementation risk

Market reaction to the details of phase one trade agreement has been muted as there is no major surprise from the deal. China’s commitment to additional US\$200 billion purchase of US goods and services over the next two years has been well documented. Although most of points are like market expectation, there are two changes which may potentially lower the implementation risk of the deal.

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First, China will purchase additional US\$32 billion agriculture products over the next two years above 2017 baseline amount. This worked out be average US\$40 billion purchase of US agriculture products per annum. This is a more feasible number as compared to US\$50 billion purchase mentioned by President Trump previously.

Second, the additional US\$200 billion purchase will not be equally split over the next two year. For 2020, China only need to complete about 38% of this US\$200 billion target.

Table 2: Increase in US exports to China over the next two years (US\$bn)

Products	Year 1	Year 2	2-Year total
Manufactured goods	32.9	44.8	77.7
Agriculture	12.5	19.5	32
Energy	18.5	33.9	52.4
Services	12.8	25.1	37.9

Source: Phase one trade deal

Those two changes will reduce the implementation risks in 2020, which will buy more time for both countries to go deeper into the structural reform.

What's next?

Agriculture purchase, currency and financial services are low hanging fruits, which have been well covered in the phase one deal. On currency, transparency and communication are two key words, which are largely in line with market expectation. We think the impact of currency pact from the trade deal on RMB movement is limited. We expect China's fundamental to play a bigger role in RMB's movement in 2020 although the progress of trade talk is expected to continue to dominate the headline. Even without additional rollback of existing tariff this year, we still think there is still room for the USDCNY to test 6.80 on the back of improving macro outlook.

Intellectual property and technology transfer are two longstanding issues that both countries will continue to work on. 18 pages out of 96 pages of phase one agreement are dedicated to the chapter of intellectual property while only 3 pages cover the technology transfer. This indicated clearly that technology transfer will be one of the key focuses in the phase two negotiation.

Overall, although it took longer than expected time for both sides to reach the phase one deal, it is still a good compromise in our view. It is probably not the time to think about what China can get out of this deal. People in China may feel better if they think what will happen if there is no deal. The removal of uncertainty from the trade war is clearly a good thing for both countries.

We believe the relatively lower implementation risk for the phase one deal will allow us to enjoy more peaceful period. Let's stay calm and move on.

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Market may start to shift their focus back to fundamental pictures while keeping an eye on headline news about the phase two negotiation.

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