The Gazette
PULITZER PRIZE-WINNING JOURNALISM, EST. 1872

Trade war presents lingering recession threat

Sean Higgins

November 6, 2019

Passengers walk by merchandise on display at the Shanghai Disney flagship store at Hongqiao Railway Station in Shanghai, China, Monday, Oct. 14, 2019. China's trade with the United States fell by double digits again in September amid a tariff war that threatens to tip the global economy into recession.

Fears that the President's Trump's trade war with China will lead to a recession may have faded from the headlines, but economists say it cannot be discounted.

"We're not expecting a recession anytime soon, but, that said, there are a number of headwinds, ranging from slower growth, trade tensions, a gradual erosion of confidence in the private sector, and gradually slowing employment gains, among other policy risks, that could push us towards an environment that could potentially be recessionary," said Gregory Daco, chairman of the National Association for Business Economics' Outlook Survey.

Even if all trade with China was hit with tariffs, the drag on growth would only shave about a half of a percent off of the gross domestic product for the United States, Daco noted. The trade war alone could not induce a recession, he argues, although it could be a catalyst for broader problems.

That many businesses have acted to avoid trade war damage could be part of the problem. Businesses have built up inventories, put off investments, and shifted parts of their supply chain in anticipation of tariffs. But they are running out of room to maneuver, and so the tariffs could start to be felt more broadly.

"If you have an environment where businesses have prepared for the worst by stockpiling inventory, or if consumers had been spending more than they otherwise would have to protect themselves from a potential tariff hit later, then the risk is that on the flip side you get a significant hit pull back on investment and spending later that pushes you into a recessionary environment," Daco said. "We're likely to see some subdued growth in the fourth quarter of this year because of this."

The White House and Beijing are currently continuing talks to resolve the trade fight, but the progress is only gradual. Several issues have been addressed, both sides claim, but some of the thorniest ones, such as forced technology transfers, remain unresolved and are likely to be kicked further down the road.

Last week, the Labor Department reported that the unemployment rate was 3.6%. The numbers calmed markets worried about the potential for a recession while the Trump administration touted them as proof of the underlying economic strength.

Employment, however, is a lagging indicator, said Wayne Winegarden, a senior economist with the free-market Pacific Research Institute. A better metric is business investment, which he argues has been "terrible."

Gross private domestic investment declined 1.5% in the third quarter, according to Commerce Department data, after dropping 6.3% in the second quarter.

That is partly a consequence of the trade war because its creates uncertainty that makes businesses reluctant to invest, Winegarden said. The risk of a broader trade war with China still exists, and other trade war fronts could open as well. "How many times have we gone back and forth on whether we will go ahead on European automobiles?" he said, pointing to Trump's threat to slap levies on autos and auto parts.

"The other factor is that the tariffs have not until more recently been placed on items that consumers would notice," said Inu Manak, trade policy expert for the free-market Cato Institute. Consumers have largely avoided the tariffs' impact thus far, according to a working paper circulated last week by the National Bureau of Economic Research. It found that a 20% tariff on a product was associated with an increase of only about 1% in the product's retail price.

That's likely to start changing, Manak said, pointing to the case of Apple, which has made a number of requests to the U.S. Trade Representative's office for products to be excluded from tariffs, as a sign that the effect of the tariffs are starting to reach popular consumer products.

"That said, I'm not sure we can say with any certainty that the average American is going to connect the dots between rising prices and the tariffs," Manak said. "If that doesn't happen, I don't see the administration backing down, regardless of how much it hurts. They certainly aren't responding to the calls of companies asking for tariff relief. And I wouldn't hold my breath for Congress to act either."

It mainly comes down to how the trade fight is resolved, said Gary Hufbauer, nonresident senior fellow for the Peterson Institute for International Economics. "If Trump reaches some sort of agreement with Beijing and doesn't start a trade fight with the European Union over autos, I think the adverse effects of prior tariffs on the economic outlook will begin to fade," he said. "But if Trump ramps up the trade fights, then the chances of a real recession — not just a slowdown — will escalate to over 40% by next fall."