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US-China trade war might lead to a global recession

What is the issue?

- Researchers at Morgan Stanley (an investment bank) has alerted that if the US-China trade war continues for the next 4 to 6 months, a global recession could occur within the next 9 months.
- The last massive downward spiral in the global economy happened in the wake of the great financial crisis of 2008 and continued till 2010.

What is a global recession?

- In an economy, a recession happens when output declines for two successive quarters (i.e. 6 months).
- However, for a global recession, institutions such as the International Monetary Fund tend to look at weakness in the economic growth rate, and also at the widespread impact in terms of the impact on employment or demand for oil etc.
- The long-term global growth average is 3.5%. The recession threshold is 2.5%.

What has triggered the alarm?

- On September 1, 2019, **US imposed 10% tariff on imports from China**, which escalated the trade tensions between the US and China.
- In retaliation, **China threatened to take countermeasures**.
- Then, **US declared China as a "currency manipulator"**. In other words, the US accuses China of deliberately weakening the yuan to make Chinese exports to the US more attractive and undercut the effect of increased tariffs that the US is employing.
- The renewed trade tensions threaten to derail the already struggling global economy.
- The global capital expenditure cycle has "ground to a halt"; since 2018, there's been a sharp fall-off in nominal capital goods imports growth.
- Central banks around the world are cutting interest rate in a bid to shore up global economic activity.
- To some extent, this monetary policy is countering the adverse impacts of trade wars and all-round global uncertainty (Brexit, geopolitical tensions in West Asia, and between the US and North Korea).

How do higher tariffs affect growth?

- According to Morgan Stanley, $2/3^{rd}$ of the goods being lined up for increased tariffs are consumer goods.
- Higher tariffs are not only likely to **saturate the demand** but, also **hit business confidence to invest more**.
- **Reduced capital investment** would reflect in **fewer jobs**, which, in turn, will show up in reduced wages and eventually **lower aggregate demand** in the world.
- What makes this scenario tricky is the fact that **monetary policy is already loose.**
- Ideally, the global economy should not risk reaching a recession at a time when the monetary levers may not have a lot to offer.
- In fact, at present, the **trade tensions and uncertainty is negating the positives** that a cheap money policy could provide to the world economy.

Source: The Indian Express