QNB Economics
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Leaders pause for breath at the G20 Summit

The G20 summit in Osaka, Japan, provided insights to what extent membership countries and their leaders are working together on an agenda of major global issues. This summit was important as it came at a time when global economic growth is already slowing.

We observed four main takeaways from the meeting relating to the trade war, oil prices, climate change and a trade deal between the EU and Mercosur.

First, there was effectively a cease-fire in the trade war between the US and China as Presidents Trump and Xi agreed to restart their trade negotiations. Despite no significant progress on substantive issues, an upbeat Trump said "We discussed a lot of things, and we're right back on track". Trump indicated that he was considering easing restrictions on US companies supplying Huawei and that China had agreed to increase purchases of US agricultural products (e.g., soybeans). The US also put further tariff increases on hold for the time being.

However, the US could quickly impose tariffs on the remaining USD 300 Bn of goods not yet subject to tariffs. The US has, so far, tried to avoid imposing tariffs on consumer goods because the impact of such tariffs on US consumers would be much greater than for earlier rounds. It would take time for US retailers to find alternative suppliers and costs would be higher, pushing up prices and hitting corporate profit margins. Higher prices (i.e., inflation) would hit consumer demand and may constrain the Fed's ability to lower interest rates in response to weaker GDP growth. We assume Trump's advisors are aware of this, but are unsure whether Trump will see it as an opportunity to put pressure on the Fed to ease monetary policy or as too much of a risk to the economy ahead of his reelection campaign in 2020.

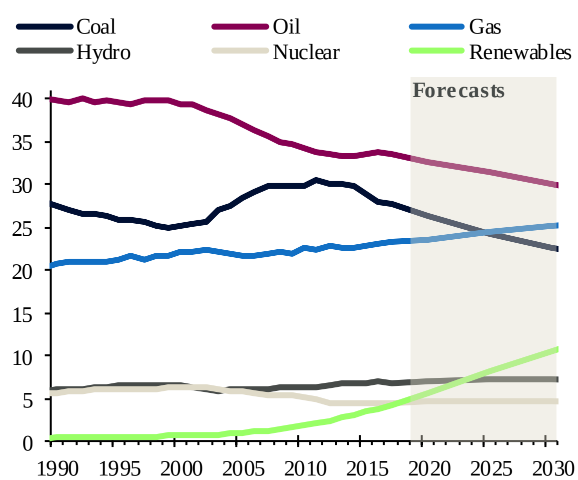
Our view remains that Trump is painting a picture of acting tough on China for the US electorate, but is ultimately keen to avoid further escalation and will push for a deal in late 2019, or early 2020. China is reluctant to play such games, so the risk is that the trade negotiations drag on or break down again.

Second, Saudi Arabia and Russia agreed on an extension of OPEC+ production cuts by six to nine months. Russian President Vladimir Putin floated the possibility of extending cuts into 2020.

The current OPEC+ deal targets production cuts of 1.2 million barrels a day. However, production has fallen by more than that as Saudi Arabia has also made deeper cuts and US sanctions impacted output from both Iran and Venezuela.

Third, climate change stood out as a clear area of disagreement between world leaders. They effectively agreed-to-disagree in the final statement, with the US reiterating "its decision to withdraw from the Paris Agreement because it disadvantages American workers and taxpayers." Whereas all other countries "reaffirm their commitment to its full implementation".

World Primary Energy Consumption
(% share by energy source)



Sources: BP energy outlook 2019, QNB analysis

Progress towards the goals of the Paris Agreement is being made on a global basis as investment in renewable energy sources continues at pace,[1]

[1] Renewables accounted for almost 45% of the world's electricity generation growth in 2018 and now provide over 25% of global power output.

helping the world to shift away from coal (see chart), the most polluting fossil fuel. Similarly, technological progress in the automotive sector (electric vehicles, batteries and autonomous vehicles) will reduce oil demand growth. In contrast, natural gas produces much less pollution and lower carbon dioxide emissions than either coal or oil. Further, natural gas helps to maintain the stability of electricity grids in many countries throughout seasonal fluctuations, weather and natural disasters. Therefore, natural gas and LNG will benefit from continued strong growth in global energy demand, despite the shift away from other fossil fuels.

Fourth, there was a ray of sunlight as the EU and Mercosur, an economic bloc of South American countries, signed a huge trade deal after 20 years of negotiations. President Jean-Claude Juncker of the European Commission noted that it was the EU's biggest trade deal and said it showed "we stand for rules-based trade". Whereas, President Jair Bolsonaro of Brazil said it was "historic" and "one of the most important trade deals of all time".

The substantive deal covers many areas, but we highlight some. The elimination of tariffs on 93% of exports from Mercosur to the EU, which will be particularly important for agricultural products. Similarly, the deal removes tariffs on 91% of goods exported by EU companies to Mercosur. However, perhaps the most important aspect of the deal is the message to Trump that a multi-polar world can adapt and respond to greater US trade protectionism.

On balance, this G20 summit was a pause for breath and an opportunity for G20 leaders to "steady the boat". There was limited progress in any area, but the only major disagreement was around climate change, which supports our view that global slowdown is unlikely to develop into a major global crisis within the next 18 months.

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