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Trade tensions. Do the odds still favor an agreement?

US trade representative Robert Lighthizer accused China of "reneging on prior commitments" and this caused that investors have had to face up to the prospect that the US could raise tariffs on US$200bn of Chinese imports to a punitive 25% as soon as this Friday. Being fully aware that the perceived probability of an escalation has risen sharply, and risk assets have sold off, we align for the moment with the idea that the most likely scenario is still that the two sides strike a deal at some point, since it is in both their interests to do so.

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Indeed, the US-China trade talks were thrown into doubt by Trump's weekend tweets, and Beijing's answer has been equally harsh. Nevertheless, some independent researchers we speak to say that this "last minutes theatrics could be designed to placate critics who think the US president is settling for too weak a deal".

According to them, it must be understood the background for this posturing. Both sides believe themselves to be in a stronger position than they were a few months ago. In the US, 1Q economic growth beat expectations and Senator Mitch McConnell backed Trump saying that Mueller report means "case closed". By its part, China managed to revive its economy, an aspect that could have emboldened Chinese negotiators to resist US demands to cut back industrial subsidies and forced technology transfers".

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After listening researchers who are familiar with negotiations, it seems that the odds still favor an agreement for Trump and Xi Jinping to sign it ahead of the G-20 summit in Osaka on June 28. Clearly, this seems the most interesting option for both leaders. In the US, the key agricultural districts have been hurt by the sharp reduction in agricultural purchases by China and Trump has to get a victory in the form of an agreement to shore up his chances of reelection in 2020.

Similarly, Chinese president Xi needed to give a boost to his unbalanced and leveraged economy, and has been using large stimulus (fiscal and monetary ones) for that purpose, but these resources are finite, so he needs to avoid at all costs an environment of external weakness that drives away international capital which could cause strong tensions in the capital market. China's leaders know this, and they moved quickly on Monday morning to announce a cut in the reserve requirement ratio for banks, in what looked like an effort to prop up investor sentiment. Xi also has internal political pressures, and needs to rebut internal critics who blamed him for provoking the crisis with the United States.

Of course nobody knows exactly what can happen, but taking into account all these factors, I would say that the most likely outcome is that a deal will still be done.

I do not know if it is due to the deep and long immersion in this financial world dominated by the Anglo-Saxons, but I suspect that I have ended up acquiring certain British reflections. Among them, one is the most important: In the storm always keep cold blood.

Best