Global Investment Event

26 March 2018

US announces tariffs against Chinese imports

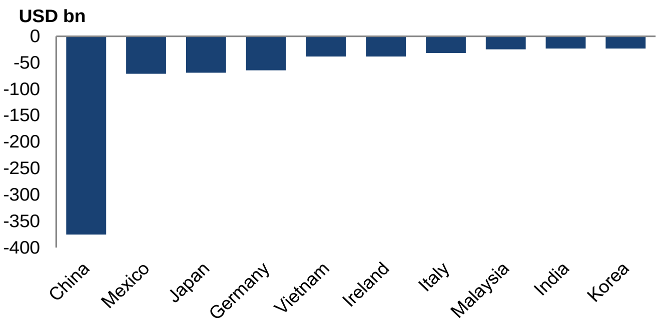
- US President Trump has signed a memorandum to impose 25% tariffs on up to USD60bn worth of imports from China, with details of goods covered to be published in 15 days' time
- China has announced reciprocal tariffs on US products worth about USD3bn if it cannot reach an agreement with the US, although this is technically in response to US tariffs on steel and aluminium
- Assuming the US tariffs are implemented, they may benefit some US producers, although this will come at the expense of higher US inflation. For China, export flows to the US may fall, but given that affected exports to the US represent only a small share of total exports, the impact should be negligible
- We expect China's overall appetite for retaliation to be limited in order to avoid a severe escalation of trade tensions. There is also space for negotiations
- For the time being, we have not altered our asset class views. World economic activity remains very strong and global trade growth is above trend. This is a supportive backdrop for global equities, and in our view current valuations remain consistent with an overweight stance in this asset class

What's happened?

US President Donald Trump has signed a memorandum directing the US Trade Representative (USTR) and the US Treasury Department to impose 25% tariffs on up to USD60bn worth of imports from China.

The order is the result of an investigation which found evidence of Chinese government practices related to intellectual property (IP) and technology licensing that the US deems unreasonable. Trump has also argued the action will help address the significant trade deficit with the country (Figure 1).

Figure 1: US trade deficits by country (2017)



Source: US Census Bureau

The USTR should announce the details of the goods subject to tariffs in the next 15 days, which are expected to target 10 key sectors identified by President Xi Jinping's "Made in China 2025" plan. The tariffs will then be imposed after a 30-day consultation period. The US will also file WTO cases against China's technology licensing policies and practices and Treasury Secretary Mnuchin will propose new investment restrictions on Chinese companies within 60 days.

China has announced plans for reciprocal tariffs on 128 US products worth around USD3bn – technically a response to US tariffs on steel and aluminium – if it cannot reach an agreement with the US. Initially, this would include a 15% tariff on steel pipes, fruit and wine, and then a 25% tariff on pork and aluminium scrap. China also plans to take legal action against the US under the WTO framework.

What's the potential impact?

Assuming the tariffs are imposed, they may benefit some US producers, although this will come at the cost of higher US inflation, potentially weighing on real purchasing power and consumption. However, the tariffs cover only roughly 15% of goods imports from China, and 2.5% of total US goods imports, so the overall impact on US prices should be minimal. Chinese exporters may also cut their prices to maintain market share, so end prices paid by US consumers would be broadly unchanged.

For China, export flows to the US may fall, and margins could be squeezed for those firms who cut prices to maintain competitiveness in US markets. But given that goods exports to the US affected by the tariffs represent only 2.7% of China's total exports, the overall impact on the economy should be negligible.

Investment implications

For the time being, we have not altered our asset class views. The economic impact of the US and Chinese measures announced so far is likely to be very small. We also expect China's overall appetite for retaliation to be limited in order to avoid a severe escalation of trade tensions. The 30-day consultation period creates space for negotiations, whereby China may make concessions, including services market access, and enforcement of IP rules.

World economic activity remains very strong and global trade growth is above trend, providing a supportive backdrop for **global equities**. In our view, current valuations remain consistent with an overweight stance in this asset class.

However, we continue to monitor the situation closely and will communicate the potential implications of any further escalation in due course. In our view, the bigger risk lies in an all-out global trade war with further rounds of tit-for-tat actions, affecting an ever larger share of economic output.

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