Global Economics & Markets Research
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Macro Note

US: Trump Steps Up Trade Tariffs Against China

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- US President Trump's threat to toughen measures against countries having significant trade surpluses with the country and perceived to have in place unfair practices, have continue to materialize, which leads to escalating concerns over a global "trade war". On Thursday, President Trump signed an executive memo issuing the instructions to US Trade Representative Robert Lighthizer to levy tariffs against at least US$50bn of Chinese goods over intellectual-property violations based on US Trade Representative's (USTR) Section 301 investigation. This is a follow-up to Trump's directive in August 2017 for USTR to begin investigation into China's laws, policies, practices, or actions that may be harmful to the U.S.

- The tariffs specifics are to be published by USTR within 15 days and industries get 30 day comment period. In his speech, Trump says that he views China as a friend but there is a tremendous intellectual property theft situation with China, and the US trade deficit with China is "out of control". He asked China to reduce trade surplus immediately by $100 bn and he warned that this is "the first of many" trade actions.

- China's Commerce Ministry said on Friday that while it does not hope for a trade war, the country is "not afraid of engaging in one". The ministry responded with a statement that proposed to take aim at 128 products imported from the U.S., to be implemented in two stages if an agreement cannot be reached with the U.S. while legal action under WTO could also be considered. The first stage will involve 120 products (with import value of US$0.98 bn) which include items such as wine, fresh fruit, dried fruit and nuts, steel pipes, modified ethanol and ginseng that could be imposed 15% duty. At the second stage, 8 products (with import value of US$1.99 bn) including pork and recycled aluminum goods will be imposed 25% tariff rate. In total, the targeted imports from the U.S. had an import value of $3 bn (based on 2017 trade), which is around 2.3% of the value of US' goods exports (US$130 bn) to China in 2017. China accounts for 8.4% share of total U.S. merchandise exports for the year.

- The reason for targeting China in its trade measures is clear. US' bilateral merchandise trade deficit with China rose to a record US$375.2bn in 2017 (2016: US$347.1bn) despite President Trump's tougher trade rhetoric since his presidency. This accounted for around half of total US trade deficits in 2017, and is 4.4 times the bilateral trade deficit back in 2000.

- The impact of the newly announced U.S. tariffs will be far more wide-ranging and deeper compared to the earlier steel measures which have a direct impact on only around US$0.6bn of direct steel exports from China to the US.

- Although US' trade measures to date are focused mainly on China, the spillover should not be underestimated as consumers would be affected by higher prices as a result of the tariffs and this could be expected to weigh down the global growth outlook.

- For now, the unfolding trade tensions are not expected to have significantly negative impact on global economic growth this year but the extent of the impact depends on any tit-for-tat reactions from China. While we can expect tough rhetoric and protests from China in reaction to the tariffs, retaliatory actions from China could in fact continue to be rather restrained which will help to contain the overall fallout in global trade. In fact, China's proposed counter measure targeting US$3 bn of U.S.' exports is relatively small in comparison to US' tariffs on at least US$50bn of Chinese goods.

- As a contribution to China's GDP growth, net exports' share is fairly small which suggests that the overall trade impact on China's economy could be smaller than feared, though there will be some transmission via a slowdown in fixed investments and private consumption (which are significant contributors to China's growth).

- Based on the timeline for the USTR to publish the tariffs specifics and consultation with the industries, any trade tariff measures will likely be implemented only sometime in May. Until then, there would still be significant uncertainty while the most optimistic outcome would be for U.S. and China to come to some sort of agreement and avoid further trade tensions from building.

- Another way the US may force through trade protectionism is possibly through labelling China as a "currency manipulator" in the semi-annual US Treasury FX report as an indirect route of forcing trade restrictions. If US raise currency manipulation argument at WTO, China has said that it is prepared. The next semi-annual report will be due in April 2018. This could come ahead of any import tariff implementation.

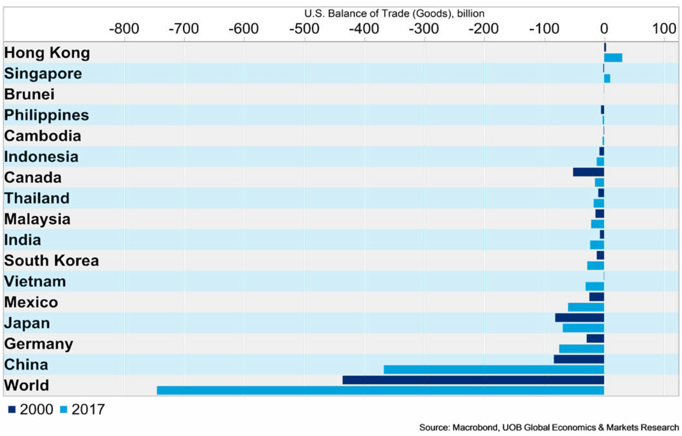
- The fear of escalating trade tensions between the world's 2 biggest economies sent US stocks to its worst tumble in 6 weeks while US Treasuries rallied on Thursday (22 March). The USD finished higher against most G-10 peers with the exception of JPY and CHF. As we cautioned back in November 2016 when Trump won the US presidency, trade and currency are areas of particular concerns for Asia due to his more inward-looking orientation. This could bring about more currency volatility. Although the CNY may well weaken and drive Asian currencies lower should the region's exports get negatively impacted, an alternative view is that Asian currencies, especially the Chinese yuan, could face some upside pressure if China is labeled as a currency manipulator.

- Ahead of the announcement, the CNY weakened from about 6.3150 to 6.3350 per USD yesterday (22 March). Since morning, the response in the CNY has been muted, hovering in a small range between 6.3250 and 6.3340. At this juncture, markets seem reluctant to price in the worst fears of a "trade war", evidently as offshore CNH remains stable and trades close to the onshore CNY while the 3-month implied volatility remain depressed at 4.9% annualized, lowest levels since 18 January.

- As the situation remains fluid and until more details surface, we are inclined to keep to our current set of FX forecasts. Guided by US Federal Reserve continuing its steady monetary policy normalization, we see USD/CNY inching higher from hereon, to 6.35 in 2Q18, 6.40 in 3Q18, 6.45 in 4Q18 and 6.50 in 1Q19.

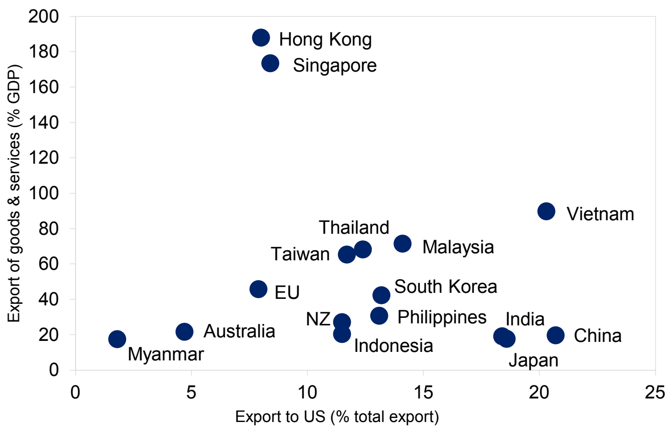
China Stands Out, Having The Largest Trade Surplus With The US

Source: Macrobond, UOB Global Economics & Markets Research



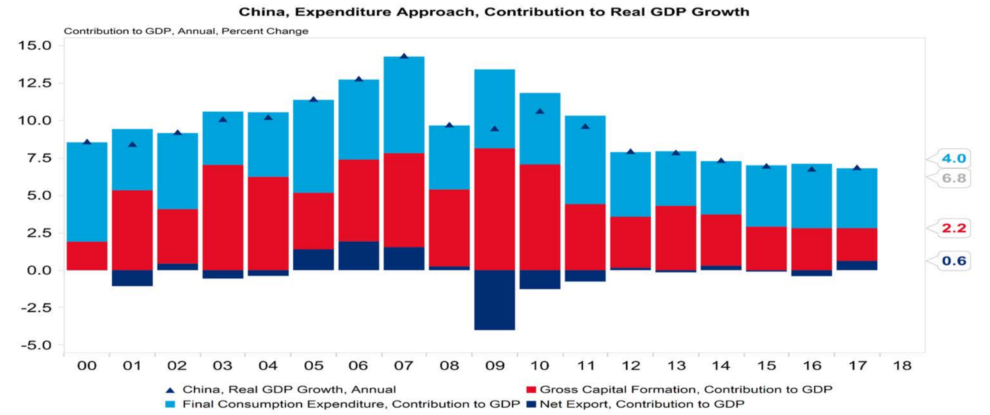
Vulnerability To US Based On Export Exposure: China, Japan, Vietnam & India Clearly Stand Out

Source: CEIC, Bloomberg, UOB Global Economics & Markets Research



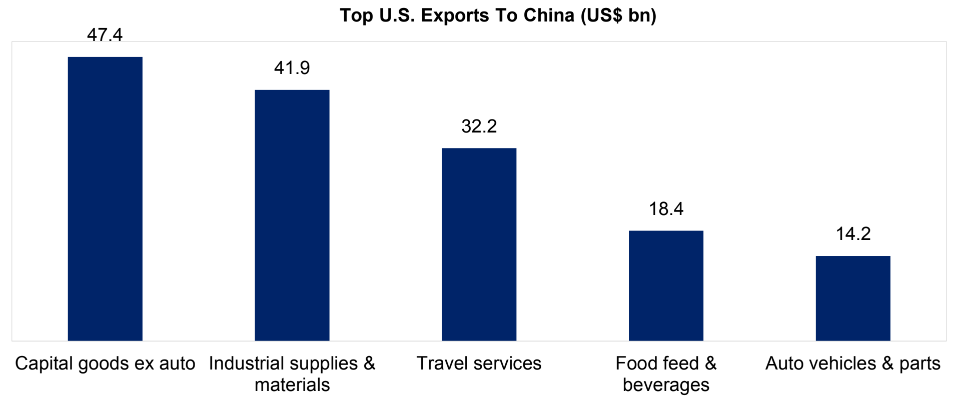
Contribution To China's GDP Growth

Source: Macrobond, UOB Global Economics & Markets Research



Potential Targets For China

Source: Bloomberg, UOB Global Economics & Markets Research



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