Current Market News

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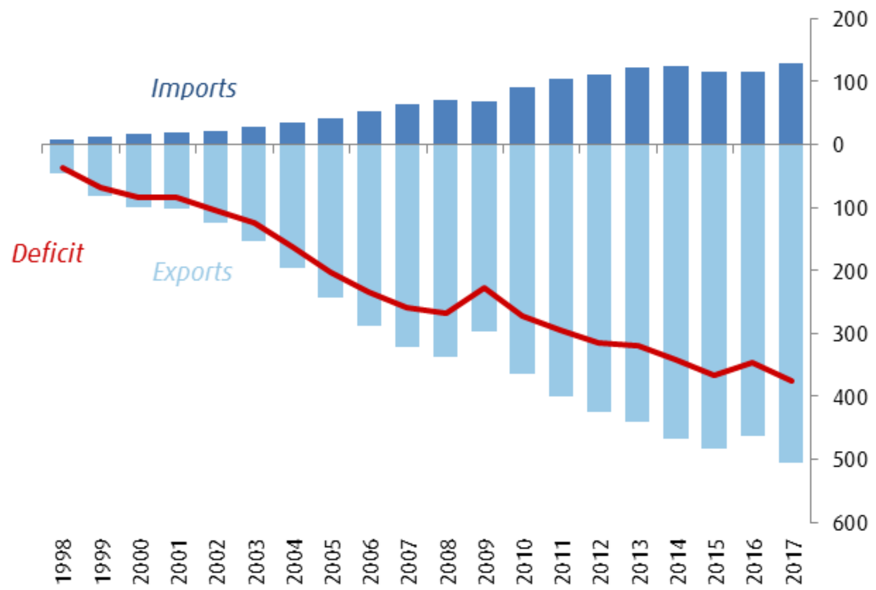
U.S. – China Trade War: No end in sight

The trade war between the world's two largest economies keeps escalating as neither side is willing to back down.

After hitting each other with tit-for-tat tariffs several months ago, this week President Trump amplified U.S. trade pressure on China. He authorized a tariff of 10% on $200 billion of additional imports starting September 24th. The tariff on these goods increases to 25% on New Year's Day 2019. Furthermore, the President threatened to impose tariffs on an additional $267 billion of imports if China responded in kind.

President Xi Jinping wasted little time in doing exactly that.

Exhibit 1: United States Trade with China ($ billion)



Source: U.S. Census Bureau, BMO Wealth Management

The Chinese leader targeted additional tariffs of 5% to 10% on $60 billion worth of U.S. goods, also starting on September 24th. Though this response appears less severe in scope than the U.S. tariffs, China only imported $130 billion from the U.S. last year ***(Exhibit #1)***, so it's running out of goods to tariff.

As stated previously, the Trump administration's goal is to force China to halt what it perceives as restricted market access and rampant piracy, especially related to technology and intellectual property. China disputes this is a problem. The good news for the U.S. is that it relies far less on exports to support its economy. Much of U.S. trade is Florida selling to Minnesota, California buying from Illinois, and so on.

But trade wars hurt everyone. The initial rounds of tariffs put the two countries in danger of getting a skinned knee, seeing inflation rise on the margin and economic growth fall on the margin. These new rounds of tariffs could leave bruises, more noticeably cutting real GDP growth. Business sentiment,

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which remains high in the U.S., may also begin to suffer if companies postpone investments due to the changing global landscape. Of course, the short-term economic outcome is difficult to forecast given recent stimulus measures taken by China, and the potential for the U.S. Federal Reserve to adjust its tightening path should business conditions deteriorate.

All of this is likely to lead to increased market volatility around the world. That said, the Trump administration has abruptly reversed course in the past such as when threats to North Korea gave way to a cordial summit. Moreover, Chinese diplomats are currently discussing whether or not to accept an invitation from Treasury Secretary Steven Mnuchin to resume trade discussions. In this round of tariffs both sides took an approach that was more moderate than expected, and this restraint suggests a willingness to talk exists. The built-in January escalation clause also provides a discrete timeframe for compromise before further damage is done. However, until U.S. sees signs that China is willing to address core market access and intellectual property/technology transfer accusations, the trade war is likely to continue.

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