FINANCIAL MARKETS

TRADE WARS?

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TRADE: THE BIG PLAYERS

FOREWORD

President Trump first imposed steel and aluminium tariffs back in March. In April, China responded with direct tariffs of its own. This is when a supposed 'trade war' began.

On May 20th, China's vice-premier Liu He announced that the trade war between China and the US was now on hold. They both agreed to back off from threatened tariffs to discuss fair deals.

Uncertainty around trade arrangements still lingers. In this eBook, we'll analyse how trade relations between the US and China could evolve.

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COOLING TRADE TENSIONS

WHAT'S HAPPENED?

Since early 2018, trade tensions have been building between the US and China.

This started with the introduction of US import tariffs on steel and aluminium - a move which penalises state-supported Chinese steel.

Since then, it's been a game of protectionist rhetoric. Clearly aware of the mutual dangers of retaliatory tariffs, this has made the US and Chinese governments keen to cool tensions and reach a compromise on trade.

After talks in May 2018, the White House said in a statement that China had agreed to reduce the current $375 billion trade deficit. Despite these claims, China's Foreign Ministry has denied that it will its trade surplus by $200 billion.

Remember - an integral part of President Trump's 'America First' agenda is to renegotiate current trade arrangements to give the US a 'better deal'.

However, President Trump has likely seen the need to keep China onside from a geopolitical perspective. This is evident in his efforts to build a strong personal relationship with the Chinese President Xi Jinping.

The fluid situation with North Korea also means that President Trump needs to leverage his relationship with President Xi in order to influence North Korea's Supreme Leader Kim Jong-un.

At the time of writing (May 2018), US import tariffs on aluminium and steel still stand, but so do Chinese import tariffs on some US products, such as wine.

WHY WOULD A 'TRADE WAR' BE BAD?

A trade war between the US and China has the potential to hurt business in both countries.

For instance, by introducing aggressive import tariffs on steel and aluminium, the US has made it more expensive for American businesses to source steel from China.

China's retaliatory tariffs - on strong US export markets, including meat and wine - make it more expensive for Chinese businesses to buy certain US products.

This escalation could also result in the US and China competing for export market share. For example, Beijing has pledged to continue to grow its export markets in other parts of the world. Considering how aggressive the US has been in pursuing an 'America First' trade policy, there is a risk that US exporters could lose market share as export markets shift towards countries with barrier-free trade.

Keep in mind that China also has an emerging middle-class. With this in mind, it's likely that the Chinese economy will shift from being an 'export-driven economy' to a 'consumer-based market'.

Home to many of the world's leading global businesses across different industries, the US will want to ensure its businesses can access the Chinese market in the future. This is another potential reason why the US is looking to cool 'trade war' tensions.

A US/CHINA TRADE DEAL?

THE STATE OF PLAY

So we now understand why the US and China want to cool 'trade war' tensions. But are we actually any closer to a resolution?

At this moment in time (May 2018), there's yet to be a definitive breakthrough. After seemingly encouraging signs from both parties, difficulties have surfaced.

As mentioned, trade deal talks appeared to start well and with enthusiasm. Specifically, President Trump announced a breakthrough in agriculture: "China has agreed to buy massive amounts of ADDITIONAL Farm/Agricultural Products - would be one of the best things to happen to our farmers in many years!"

While monetary specifics of are sparse, if this is confirmed, this could be good news for US soybean farmers. As trade pressures increase on US farmers, competition from Brazilian counterparts has loomed large.

What's more, the Chinese have deeply invested in Brazil's roads and railways. This has given Brazil the opportunity to use more land and increase soybean production at a quicker rate. Production could increase by approximately 9.5 million hectares over the next 10 years.

However, the US still has advantages over Brazil in terms of infrastructure. Should a US/China trade deal be secured, the 25% Chinese import tariff on US soybeans would be a relief to American farmers.

But an actual 'trade deal' is still a way off. Despite US Treasury Secretary Steve Mnuchin announcing that a 'framework' had been agreed, President Trump has since expressed doubts, commenting that any deal would need to be 'restructured' to see it come to fruition.

So what's changed? Some speculate that President Trump is facing political pressure at home to not be too accommodative to China.

For example, the US president has come under fire for plans to lift restrictions on Chinese telecommunications company ZTE. This company is currently prohibited from selling smartphone components in the US because of China's foreign policy stance on Iran and North Korea.

MARKET REACTION

It remains to be seen whether a trade deal between the US and China can be secured. Yet one thing is certain - should fears of a trade war heighten, the markets will reflect investor anxiety, while the US dollar will face downward pressure.

Our advice to traders is to watch trade deal talks between the US and China closely, paying particular attention to rhetoric from Washington an Beijing.

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