The Global CIO Office Weekly

Trade Wars - the Strategy of Losers

- **President Trump leaves markets in a state of flux as tariffs on Chinese imports are increased despite ongoing dialogue.**
- **China is unlikely to escalate give the lack of targets for higher tariffs**
- **Some US businesses are aware that much is to be gained through a more positive engagement with China.**
- **Chinese consumers replace western baby boomers as the driver of global growth.**
- **US and Chinese data will show who are the near-term winners and losers.**
- **Equities sell-off should prove transitory**

Note to President Trump; General Motors, sold 3.65 million vehicles last year to Chinese buyers, compared with fewer than 3 million to Americans. The automaker earned $2 billion last year from its joint ventures in China. Honestly, sir, it's a more even playing field than you give credit.

The global equity markets saw the most significant weekly fall since the start of the year as President Trump's poker game with China continued. What can we say about the current situation

• A trade war has only losers. President Trump may try to make out otherwise, but the IMF and many others cite significant downside to global growth from the waves of sanctions. The US at the end of last week hiked tariffs by 15 percentage points to 25% on US$200 billion of Chinese goods. Trade talks have not come to an end, but the Chinese delegation has gone back to China with the hope for a further round of talks in Beijing at some stage in the future. Long live the hope of a 12th round of talks.

• President Trump is sensitive to the impact on markets and his supporters. In our view, President Trump is targeting a vibrant equity market. Hence the President is likely to change tack if his tweets and hard-balling strategy starts to lead to the significant downside on financial markets. He has also been sensitive in the past to the challenges that his tariffs have brought to the agriculture sector in particular.

• In the very near term investors are scrambling for cover; the US equity market has suffered from the heaviest retail selling since the start of the year. The Yen has risen to a three-month high, and the US 10-year bond yield was at one stage below the three-month bill rate.

• China doesn't have the ability to hit back hard as it has a far lower level of imports to raise taxes on. It is left with just $10 billion of untaxed imports. It could limit sales of rare earths (China has a 90% share of the global market) which are crucial for the technology industry. However, it tried such a move with Japan in 2010, but that merely raised the prices of rare earths which ultimately led to previous sources of rare earths from outside China coming back on line.

- The US should really look at the bigger picture. The big opportunity for the US is to do business with China rather than necessarily have to export things to them. As the Washington Post recently reported global dynamics are very different now to the past. Chinese consumers bought 85% of what they produce compared to 71% a decade ago US companies need to be involved in the Chinese domestic markets not just exporting to it. The opportunity with Chinese consumers is enormous. Chinese consumers are taking over from the western baby boomer as the driving force of global consumer spending growth. By 2030, fast-growing developing countries led by China are expected to account for 51 per cent of global consumption, nearly double their 2007 share, according to a study by McKinsey Global Institute. Since 2009 US-based multi-national have increased their Chinese workforce by 86% to 1.7 million roughly four times the rate of growth in the US.

- Dare I say it, but the US needs to get wiser to Chinese culture. Ford recently recognised its mistakes. The company has changed strategy by swapping out thirty expatriate managers for local talent. The group reported a $1.7bn loss in China last year after sales fell 37 per cent, the most significant slump to hit a prominent international manufacturer in the market.

- Other countries don't easily win from the spat between the United States and China. Replacement of suppliers of Chinese products by say India or Vietnam is easier to say than do. Few countries have a supply line built to take market share from Chinese exporters. Chinese exports mainly machinery, electronics and plastics. Moreover, there is no telling if the US will train its sights on other emerging countries more forcibly in the future.

- The main winners to date appear to be manufacturers of low value-added items. Mexico for example. US imports of Mexican goods rose 10% in 2108, the most in seven years. After the US levied tariffs on Chinese metal ores and by-products imports from China fell $500 million, but Mexico saw a 20% increase in sales.

- Any further sanctions will only reinforce the political mood outside of the US of 'how can we do without the US'.

I think we all know that President Trump is not an economist, but one would have hoped that his advisors would point out that given relatively vibrant US economy you would expect to see a stronger rate of growth from imports rather than exports. If he wants a better balance between imports and exports, he could always take away the unfunded tax cuts and run a balanced budget!

Risk markets are understandably skittish. The trade war finally stopped the runaway rally in the US equity market. One of the most extended uninterrupted rallies since 1928. Since the S&P began its run from its low, the index had gone more than 90 days since having more than a 3% pullback from a post-recovery high price.

We sense though that the rally could re-establish itself absent a significant deterioration in trade talks. The US economy although disappointing on some fronts is still rattling up a reasonable rate of growth. Until there is a substantial downturn in growth or a more serious risk is a Fed rate rise it is difficult to see a significant setback of markets.

Watch this week for a series of speeches from Fed officials to see if there is any change of mood on when they will raise rates. Secondly, retail sales and industrial production data will be a good take on the current pace of growth. Retail sales soared 1.6% in March and should show a more moderate 0.2% month-on-month rise in April.

Data watchers will be looking to see what toll the trade talks have had on Chinese activity. Industrial production growth is expected to ease from 8.5% year-on-year in March to 6.5% in April. Investment growth at 6.3% year-on-year and retail sale growth at +8.6% year-on-year should be in line with March data.

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Singapore, Dubai and London, 13th May 2019