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US threatens $200bn worth of tariffs on Chinese imports

The dust barely had time to settle from the US' blow to China on July 6th where it levied $34bn worth of tariffs on its imports, before the Trump administration fired its next shot in the escalating trade spat between the two superpowers. On Tuesday this week, the US renewed threats to impose $200bn worth of tariffs on imports from China. Trump is following through on his assertion that if China retaliates, then he will amplify his actions (potentially as far as imposing tariffs on all $500bn worth of Chinese imports). This is of course sending shivers through global markets which in July had refocussed away from trade war worries.

The $200bn threat was made more concrete by an accompanying list of proposed products that would be targeted. The list - which includes products such as cotton, furniture, luggage, burglar alarms and refrigerators to name but a few - seems to target key Chinese manufacturing export industries. The National Retail Federation in the US has said that the measures would "boomerang back" negatively impacting US families and workers. Interestingly,

Mr Gao Feng, a spokesperson for the Chinese Ministry of Commerce revealed that of the $34bn worth of goods already targeted by the US, roughly 59% were produced by foreign companies, a significant proportion being US firms.

The question still remains as to how China will respond. Beijing has promised to retaliate in full proportion but if the $200 billion in tariffs materialize, this becomes unfeasible: In 2017, exports from China to the US amounted to $505bn, whereas those from the US to China reached only $130bn. Without the same level of exports to target, we can only surmise about how China may react. Two nuclear options would be: currency devaluation (the yuan has already depreciated 4.3% against the US dollar since mid-June) and/or dumping its US Treasury holdings (worth $1.18trn - about 5.6% of total outstanding US public debt). At the moment, neither is given a high probability. Explicit currency devaluations could risk eliminating investor confidence in the yuan. The latter option would be difficult to enact in practice and would also likely push up the value of the yuan.

A potential play could be to target US businesses operating within China. China's consumer spending has become the major growth engine of its economy and many US firms are actively tapping into this. For example, General Motors, the quintessential American car brand sells more cars in China than it does in the US. China could limit the repatriation of profits or even encourage boycotts of US brands as China has done against Japanese brands in previous disputes.

We are starting to see the evolution from rhetoric into concrete action, without signs of abating for the time being. Even the US Federal Reserve has cited concerns saying that: "*for the first time we are hearing about decisions to postpone investment, postpone hiring, postpone making decisions. That is a new thing. If you ask is it in the forecast yet, is it in the outlook, the answer is no*."

Given the current lack of clarity as to the next steps from both China and the US, we felt it prudent to slightly de-risk out portfolios at our June allocation by selling some equities. In summer, liquidity tends to be tighter and markets have a tendency to be more reactive to noise. Whilst we take some risk off the table, our portfolios are still skewed towards equities as the underlying fundamentals indicate that the global economic expansion still has room to run. In the event that a trade war does materialise, we have decreased exposure to the regions which would be hit the hardest (Europe and Emerging Markets).

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