

Caught in the Crossfire

27 July 2018 | Arminius Capital

President Trump's latest tweets and interviews clearly indicate that he intends to go ahead with his trade wars. This is bad news for China, and even worse news for China's regional suppliers like Australia, Japan, Malaysia, Singapore, South Korea, Taiwan, and Vietnam. But The Donald's trade war ambitions have also expanded to include Canada, Mexico, and most European countries.

We shouldn't be surprised. Back in March this year, he tweeted, "Trade wars are good, and easy to win." But what is surprising is the number of fronts he is choosing to fight on. The China front is the most visible, but not necessarily the biggest.

After four rounds of trade talks with China, the Trump Administration unilaterally decided to impose tariffs on Chinese goods imported into the US. In 2017 exports of Chinese goods to the US amounted to USD\$505bn, compared to USD\$130bn of exports of US goods to China, hence the US trade deficit in goods was USD\$375bn. The US began with a 25% tariff on USD\$50bn of Chinese goods, then indicated that a further USD\$200bn would be tariffed at 10%. Last week President Trump said that he was willing to tariff the whole USD\$500bn. So far, the Chinese government has retaliated only by placing tariffs on similar amounts of US goods, but it has several other ways in which it could retaliate – e.g. boycotts of US goods, harassing US companies operating in China, restricting tourist and student travel to the US, and selling down its holdings of US government debt. (These are detailed in our Geldzug dated [18 April 2018](#)).

Last week President Trump has accused China, the EU, and unspecified other countries of manipulating their currencies and interest rates lower in order to offset the effects of US tariffs. The Chinese renminbi has in fact been falling this year because of fears of a trade war, and because of the effect of foreign investors pulling money out of China. (The Shenzhen share market has fallen 22% from its peak in January 2018.) Needless to say, a currency war – based on competitive devaluations – would make any trade war much worse.

President Trump has also criticized the trade policies of the EU as a whole and of many EU nations individually. In 2017 the US ran a goods trade deficit of USD\$146bn with the EU, as a result of EU exports of USD\$416bn vs US exports of USD\$270bn. (If services are included, the trade deficit shrinks to USD 113bn.) Unhelpfully, the German foreign minister suggested that the US could reduce the trade deficit if it started making better cars. The dispute between the US and the EU is still in its early stages, but – like the China dispute – it could accelerate very quickly.

[CONTACT MANAGER](#)[VIEW PROFILE](#)

Candidate Trump had threatened to pull the US out of the North American Free Trade Agreement (NAFTA) with Canada and Mexico. Three-way negotiations began in August 2017, with the intention of concluding by December. Numerous US companies and industry groups have argued against any change, pointing out that in the last twenty years they had re-configured their supply chains to benefit from NAFTA. This year Trump unilaterally imposed tariffs on Canadian and Mexican goods, and the two countries responded with tariffs on US goods. NAFTA negotiations are currently stalled.

Strangely enough, President Trump is also planning to impose tariffs on all cars and car parts imported into the US. In 2017 the US imported USD\$176bn of cars and exported only USD\$52bn, hence the deficit was USD\$124bn. German car exports to the US totalled only USD\$20bn. But the US automobile industry, which is supposed to benefit from these tariffs, is almost unanimously opposed. The industry has pointed out that its supply chains are now global, with US manufacturers incorporating parts manufactured elsewhere, just as foreign manufacturers use US parts. For example, exports of US-manufactured cars by German car makers alone amount to 400,000 cars per year. Therefore tariffs on imports will raise the price of US-manufactured cars, thereby reducing consumer demand by up to 2.0 million vehicles per year and causing hundreds of thousands of job losses in the US industry. (These figures don't include any effects of retaliation.)

With the Trump Administration fighting all these battles at once, it is unlikely that sanity will prevail. We expect that there will be an all-out trade war under way by 2019 – the only questions are how far it will extend, and how long it will last.

What is clear is that, while some industries in the US and China will be adversely affected, the US and Chinese economies will slow down but will not be seriously damaged, because exports and imports are relatively small parts of these giant economies. The countries which suffer will be those like Australia, which are heavily dependent on trade in general and on trade with China in particular.

The threat of a trade war has already impacted commodity prices (except oil – which now reacts to tweets between Iran and the US), and the fact of a trade war will be even more painful. The Chinese economy is already slowing down, which means that it needs less Australian resources. If the Chinese authorities were to resort to large-scale fiscal or monetary stimulus, as they did in 2008, the resulting rise in credit growth would re-ignite fears of a hard landing caused by the bursting of China's debt bubble.

Therefore the Arminius portfolios remain prepared for the worst.

Insights by Australian Fund Monitors Pty Ltd (AFM) provides investors and advisors with commentary and articles originated and provided by fund managers and other contributors. The views and opinions contained within each Insights article are those of the contributor and do not necessarily reflect those of AFM. www.fundmonitors.com.

Disclaimer: Australian Fund Monitors Pty Ltd, holds AFS Licence number 324476. The information contained herein is general in its nature only and does not and cannot take into account an investor's financial position or requirements. Investors should therefore seek appropriate advice prior to making any decisions to invest in any product contained herein. Australian Fund Monitors Pty Ltd is not, and will not be held responsible for investment decisions made by investors, and is not responsible for the performance of any investment made by any investor, notwithstanding that it may be providing information and or monitoring services to that investor. This information is collated from a variety of sources and we cannot be held responsible for any errors or omissions. Australian Fund Monitors Pty Ltd, A.C.N. 122 226 724

[CONTACT MANAGER](#)[VIEW PROFILE](#)