
# Q&A: US-China Trade

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## Q: Why is the Trump administration levying new tariffs on China?

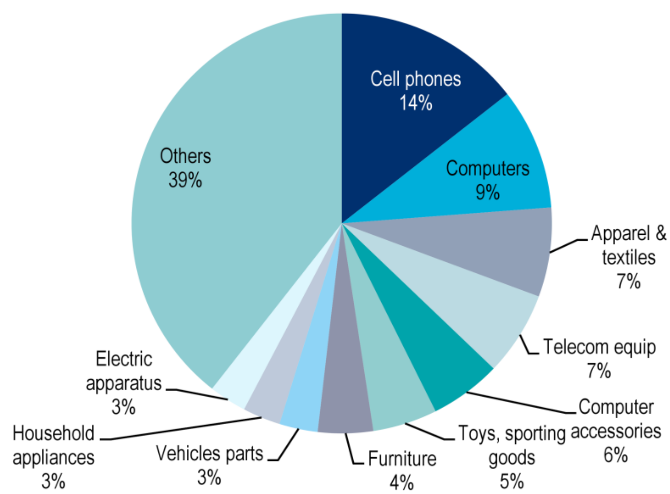
The Trump administration is planning to impose new tariffs on US$50-60bn worth of Chinese imports. According to the Trump administration, this is in response to the large goods deficit with China (over US$370bn) and also what is perceived to be unfair trading and investment practices, particularly in relation to technology and intellectual property.

The proposed punitive measures against China is based the US Trade Representative's (USTR) Section 301 investigation, though there remains room for negotiation. From a political standpoint, President Trump wishes to fulfill his campaign promises and accumulate political capital. However, given Trump's track record and his pro-business stance, our view is that a deal can be reached so as to avoid a full-fledged trade war.

## Q: What sectors/products will these tariffs affect?

A detailed list of affected products will be released in the next 2 weeks. In terms of absolute size, consumer electronics (cell phones and computers), telecom equipment, apparel, toys, furniture and household appliances are the main products that contribute to the US trade deficit with China. Hence, these are the sectors more likely to see higher tariffs applied.

### US imports from China (end-use products) breakdown




Source: CEIC, Citi, March 2018

## Q: How will China respond to these new tariffs? What are some countermeasures China could take against the US?

Chinese authorities has explicitly stated that it does not want a trade war but is prepared to take retaliatory action against the proposed tariffs targeted at China. Our view is that the measures taken by Chinese authorities will likely be measured so as to avoid further escalation and would be willing to negotiate with the US.

In terms of retaliatory measures, China could impose tariffs on US agriculture exports such as soybeans and restricting domestic sales of some US products and raising tariffs in selected sectors. However, the scope for China to really damage US interests through trade action is somewhat limited given US exports to China are equivalent to a small percentage of US GDP and total exports. In terms of non-trade measures, China could add pressure through reducing purchases of US treasuries and less cooperation in other areas, including security issue such as North Korea.

On the flip side, China could make some concessions in certain areas. This could include increasing the IP protection for US companies, allowing market access of US companies to some Chinese markets and investments and commitments to buy US aircraft or other products.

## Q: What is the impact of the U.S. tariffs on the Chinese economy?

Although total goods exports amount to nearly 20% of China's GDP, net exports only contribute to a small proportion of GDP growth. In more recent years, China has made significant progress transitioning into a more domestic demand-driven economy, first by investment and now increasingly by consumption. Furthermore, China has been diversifying its trading partners, the "Belt and Road" initiative is aimed at developing physical infrastructure and policy linkages to Europe, Asia and Africa. The share of Chinese exports to other emerging markets such as ASEAN and Latin America, has risen meaningfully in the past decade.

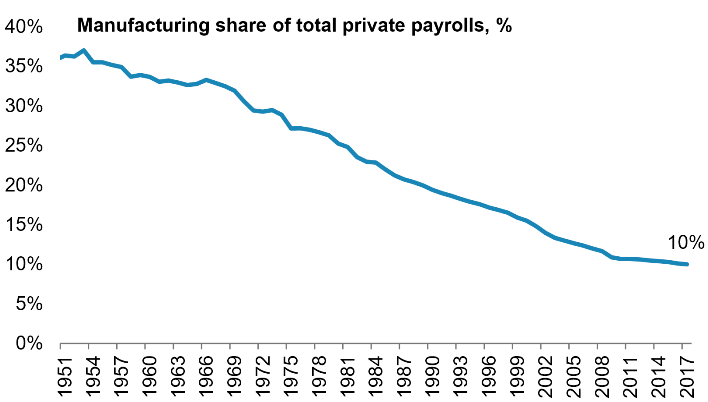

Source: CEIC, Citi, March 2018

Taking a look at earlier examples of US protectionist measures, US implemented a series of protectionist policies against Japan starting from 1981, primarily targeting auto exports and semiconductors. Japan managed to continue in maintain its market share in the US throughout much of the decade as underlying demand conditions proved to be a stronger force.

## Q: Will either country benefit from a trade war?

In short, no one stands to benefit from a trade war as ultimately it will negatively impact upon GDP growth. The impact would also extend to global value chains (accounting for two-thirds of global trade), which could result in a drag on global exports, growth and push prices up for goods.

President Trump had made trade a key theme of his election campaign November 2016, arguing that he would want to reduce the US trade deficit and bring jobs back to the US. However, it is important to bear in mind that the US trade deficit is in large part a structural issue that cannot be easily or quickly solved by trade protectionist measures. It will take some time to ramp up existing factories, build new ones and attract workers to those industries where the US has been running large deficits for years. In addition, it will be difficult for the US to displace major manufacturing powerhouses such as China, given that the latter has competitive advantages including economies of scale due to its large labor force, infrastructure and an efficient production and supply network in the region.




Source: Haver Analytics, Morgan Stanley, March 2018

## Q: Will this derail the global recovery?

A trade war between the world's two largest economies would have significant and undesirable effects globally. However, we still believe that this is an unlikely scenario. The global macro backdrop remains favorable, and as such, underlying demand for exports should remain supported if the trade situation does not escalate to a trade war.

## Q: What kind of impact will this have on your portfolios?

At this point, we have not made any material changes to the portfolios as a result of the recent US protectionist measures affecting washing machines, solar panels, steel and aluminum, as the direct impact should be small. How trade policy progresses from this point will be important and we will carefully watch for the policy response from China to gauge the potential impact.

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