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Trade Tensions Escalate from Skirmish to War

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Snapshot

- The imposition of U.S. tariffs on aluminium and steel on most U.S. trading partners represented a significant signal that the Trump administration is prepared to stress the global trading system in pursuit of its "America First" goals.
- With the U.S. and China trading tariffs recently, hostilities have risen to a new level.
- In our view, the imposition of tariffs on any product is harmful in and of itself—it hurts consumers and industrial users of the product much more than it helps the producers.

Ever since Donald Trump's presidential victory in November 2016, we have worried about U.S. trade policy taking a major protectionist turn. For the most part, though, the U.S. president's bark during his first year in office was worse than his bite. That no longer appears to be the case.

The imposition of U.S tariffs on aluminium and steel on most trading partners, including their closest ally, Canada, on the basis of national security, represented a small but significant signal that the Trump administration is prepared to stress the global trading system in pursuit of its "America First" goals. The personal feud between President Trump and Canadian Prime Minister Justin Trudeau not only torpedoed a calm ending to the G-7 meeting but endangered the North American Free Trade Agreement (NAFTA) negotiations which had seen some progress in recent months.

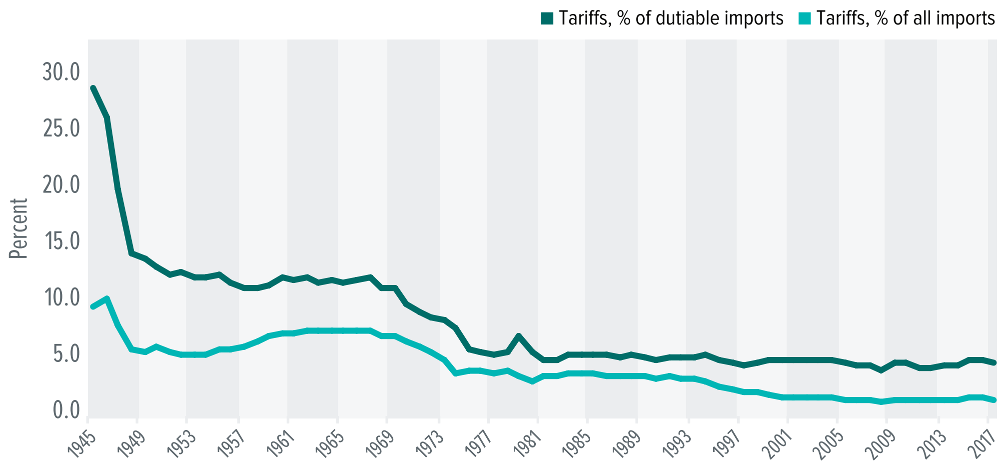
Punch and Counterpunch

A skirmish between America and China, meanwhile, has escalated into a limited-scale war. The exchanges began when President Trump proposed a 25% import tax on $50 billion worth of Chinese exports arguably to penalize China for stealing industrially-significant technologies. China immediately retaliated, announcing its own tariffs on U.S. products worth $50 billion. Not to be outdone, the White House hit back last week with suggested tariffs on an additional $200 billion worth of Chinese exports.

While these initial numbers are notable, total trade in goods between the countries (both imports and exports) totaled $636 billion during 2017, so the current level of engagement comes in at more than a mere skirmish but less than a full-scale war.

The total effect of the latest proposed tariffs would raise the overall effective U.S. tariff rate from 1.4% to about 3.4%, in line with levels last seen about 20 years ago as shown in Exhibit 1. (Effective tariff rates reflect duties collected divided by total imports. The chart captures this for all U.S. goods, not just steel or aluminium for example.)

Exhibit 1: Falling Trade Barriers in the U.S.



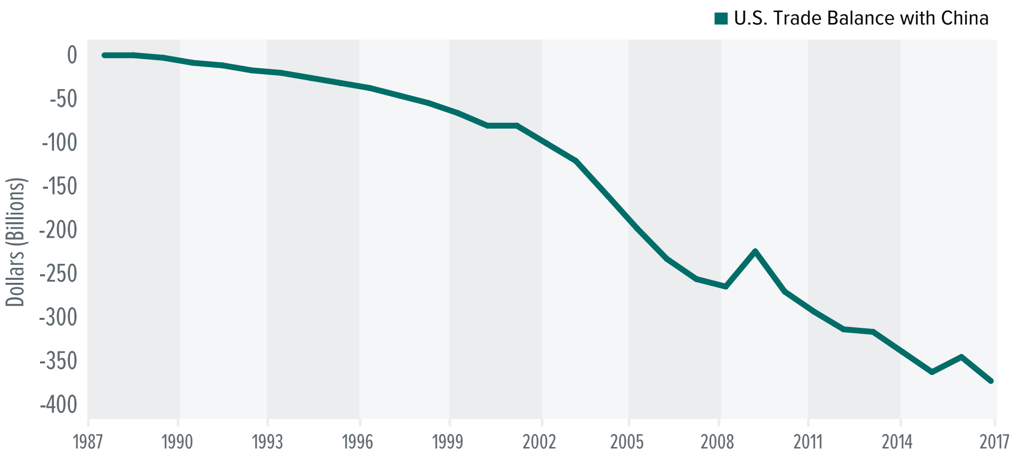
Sources: United States International Trade Commission, SEI

However, there is no guarantee that this spat will be contained. While there is still time for negotiation, the Administration's negotiating position seems to be toughening. Global stock markets have been retreating in the face of the escalation in the tariff war.

Playing to the Base

While Wall Street worries, Main Street approves. Trump was elected because he successfully tapped into the angst and discontent of Americans devastated by the loss of industries and jobs to China and other low-cost, emerging economies in recent decades. Those in the U.S. on the losing side of the global trade equation have lost big over the past 30-plus years, while emerging economies like China certainly have profited (Exhibit 2). Note the acceleration in the U.S. merchandise trade deficit with China following the latter's 2001 admission into the World Trade Organisation.

Exhibit 2: U.S. Trade Balance with China



Source: U.S. Census Bureau, SEI

Our View

We do not think these protectionist measures will result in some sort of American renaissance in manufacturing employment, but Trump's political base still will likely applaud. While investors will be unhappy, it is worth mentioning that only 32% of Americans are saving for retirement in a 401(k)—an employer-sponsored retirement savings plan—according to data from the U.S. Census Bureau, and a variety of studies show that only roughly 50% invest in stock or mutual funds at all.

In our view, the imposition of tariffs on any product is harmful in and of itself—it hurts consumers and industrial users of the product much more than it helps the producers. We will be carefully watching how this drama plays out in the days and months ahead. With any luck, the Trump administration will shy away from ratcheting tensions up further. However, we must admit that doesn't seem to be in the cards in the near term. There will be blood if the U.S. engages in a full-on trade war with China, a multi-front trade war with the rest of the world or pulls out of NAFTA.

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