# Current Perspectives

# Trump, Tariffs and Trade Wars — 3.0

## Backsliding on Trade Deal and Renewed Tensions

### At a glance

1. **At the Root of it All:** The U.S. and China continue to battle for supremacy in the global technology sector, which will likely translate to political and economic leadership for years to come.

2. **Prevailing State of Tariffs:** The U.S. recently applied a higher tariff rate on a total of $250 billion worth of Chinese products. Additional tariffs on $325 billion of Chinese goods have been threatened.

3. **TD Wealth Asset Allocation Committee (WAAC) View:** While episodes of market volatility are expected due to the ongoing dispute, we remain positive on equities and do not expect a recession.

**In March 2018, we issued Trump, Tariffs and Trade Wars, discussing the potential ramifications of the North American Free Trade Agreement (NAFTA) renegotiations. Also brewing at the same time was the escalating trade conflict between the U.S. and China.**

Fast forward to October 2018: With NAFTA replaced by the United States-Mexico-Canada Agreement (pending parliamentary ratification), we released **Trump, Tariffs and Trade Wars – Six Months Later**. This update detailed how the U.S. administration imposed the first round of tariffs on Chinese goods, backed by threats of more to come if China failed to heed to U.S. demands.

With U.S. foreign policy seemingly being discussed daily via Twitter, we return with our latest instalment of the three T's – edition 3.0. The tit-for-tat trade spat recently intensified due to delays in finalizing a new agreement. U.S. President Trump responded by increasing tariffs, following what he called China's decision to renege on key parts of the deal.

**How did we get here? Let's step back for some insight.**

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## At the Root of it all

The U.S. is currently the world's technology leader with Silicon Valley demonstrating extraordinary innovation at an accelerated rate in recent years. This has allowed the U.S. economy to outpace its developed country peers while also underpinning the strong performance of the U.S. stock market, given that technology is now the largest sector in the S&P 500 Index.

In contrast, China's growth has been driven by the manufacturing sector and by the historic migration of tens of millions of people from the countryside to the cities. However, China now aspires to move up the value chain and drive growth by investing in its own technology leadership. This can create the risk of a battle between these two global giants, and one of our key themes is that we expect persistent conflict between the U.S. and China on issues of trade and technology leadership.

> While this battle will likely lead to market volatility from time to time, **we do not expect it to push the economy into a recession or cause a major market decline.**

**Particular sources of stress in the trade spat are as follows:**

- The U.S. feels that the Chinese economy owes part of its rapid development in recent decades to heavy subsidization of targeted companies and industries – and therefore is demanding that China be more transparent and reduce subsidies overall.
- The U.S. has accused the Chinese government of not adequately protecting foreign intellectual property in China. U.S. companies are also being forced to transfer technologies to Chinese counterparts as a condition of doing business in the country. This is estimated to cost American businesses hundreds of billions of dollars every year.
- Of particular concern for the U.S. is China's **Made in China 2025** plan - a state-led industrial strategy that seeks to make China self-sufficient in global high-tech manufacturing. While many view the initiative as China's drive to advance its manufacturing industry up the value chain, the U.S. likely sees it as a potential threat to its technology leadership position. Against this backdrop, the Trump administration applied tariffs to curtail this perceived threat by charging duties mainly on products covered in the Made in China 2025 plan; including information technology and robotics-related products.
- President Trump has consistently cited the large trade deficit that the U.S. runs with China as evidence that the U.S. is being 'cheated' in trade.

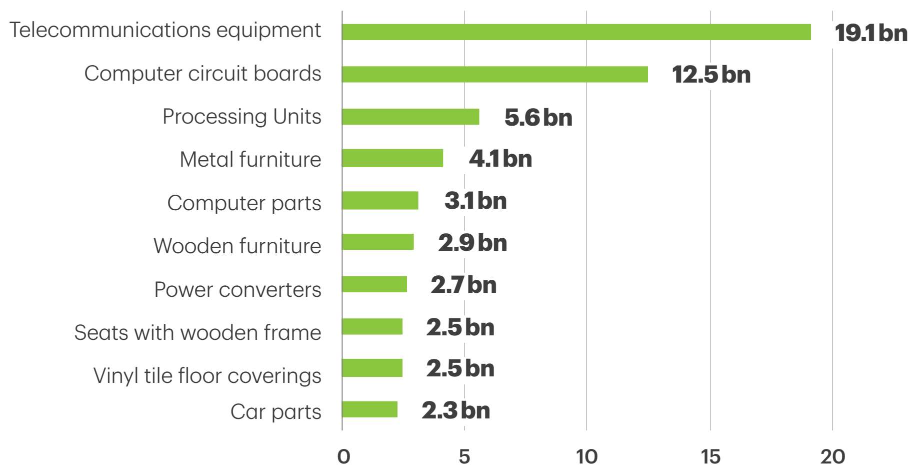
# Prevailing State of Tariffs

With that context, what's happened to cause the recent market volatility and have the previously imposed tariffs curtailed trade imbalances as intended?

- The Trump administration first imposed a 10% tariff on $200 billion of goods in September 2018, following an earlier $50 billion worth introduced over the summer of 2018.
- In May 2019, the U.S. raised the rate to 25% on the first $200 billion – now applying the higher rate on a total $250 billion worth of Chinese products. Additional tariffs on $325 billion of Chinese goods have been threatened if a trade deal is not reached.
- China reciprocated by applying duties on $60 billion worth of U.S. goods to a maximum 25% starting June 1, 2019. Impacted items include food products, building materials, and consumer goods such as furniture and electronics.
- **(Chart 1)** Where will the latest increase in tariffs be applied? About 20% of the items affected by the U.S.'s increased 25% tariff rate are telecommunications equipment related, while the Trump administration has strategically shielded most consumer electronics - such as iPhone and other everyday goods - as a means to help protect U.S. consumers.

**Chart 1: What could be hit by the new tarrifs?**

Top 10 U.S. imports from China facing a tarrif increase from 10% to 25%




Source: U.S. International Trade Commission.

- A primary goal of the tariffs was to reduce the massive trade deficit the U.S. has with China. However, recent data shows that the tariffs have done little to narrow the trade imbalance, and in fact the deficit widened to roughly $420 billion at the end of 2018. Time will tell if the recent tariff increases will deliver the desired outcome for the U.S. and narrow this disparity. **(Chart 2)**

**Chart 2: U.S. Trade with China**

U.S. trade deficit with China has soared since 1985


Source: U.S. Census.

## WAAC's View

In our view, this conflict is likely to persist for many years as the U.S. and China are the two largest political and economic powers in the world, and they continue to jostle for global supremacy in the technology sector. While this battle will likely lead to market volatility from time to time, we do not expect it to push the economy into a recession or cause a major market decline.

This is based on the view that the U.S. economy continues to be solid, corporate earnings and dividends are expanding, and interest rates remain low. It is also based on the outlook that while the U.S. and China will push each other through tough negotiations, the frictions will not devolve into an outright trade war. Trade wars are likely a 'lose-lose' affair and a U.S./China trade war can be negative for economic growth and market multiples. We will continue to monitor events as they unfold.

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