Trade Tensions Mount: What It Means for Growth

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Consistent with our view last month that the Trump administration's more significant (and market-moving) trade actions had yet to come, the recent announcement of tariffs on Chinese products related to the Section 301 intellectual property investigation has roiled markets and increased uncertainty over the possibility of a trade war.

At this point, while the administration has released a proposed list of roughly 1,300 Chinese products subject to tariffs (and is exploring tariffs on $100 billion in additional products), no tariffs have actually been imposed. The list is out for public comment until May 11, followed by a public hearing on May 15. While this theoretically leaves the door open for the U.S. and China to negotiate a settlement that avoids tariffs altogether, we are not optimistic that a compromise can be reached so quickly – especially given the less-than-productive meetings to date between U.S. and Chinese officials and U.S. policymakers' conviction that China is not playing fair in its treatment of American intellectual property.

Direct GDP impact should be modest …

With all of that said, we would expect the *direct* economic impact of the announced tariffs to be relatively modest (though negative) and to be dwarfed by the positive effects of the recent tax and spending bills on U.S. GDP.

The roughly 1,300 products potentially subject to an additional 25% U.S. import tariff in the United States Trade Representative (USTR) report account for only $46.3 billion (about 0.2% of U.S. GDP) of the roughly $2.3 trillion in goods the U.S. imported from the rest of the world in 2017, according to U.S. International Trade Commission data. The top three products (by China import value) include computers and related data processing machines and storage ($3.9 billion); media, TV and broadcasting parts and equipment ($1.1 billion); and motor vehicle seats ($0.4 billion). The U.S. can source most, if not all, of these goods from other countries. Chinese imports accounted for just 7% of the total value of these products that the U.S. imported in 2017.

Meanwhile, so far China has responded in kind. The 25% tariffs on the U.S. products identified by China's Ministry of Commerce are estimated at $48.8 billion (again, about 0.2% of U.S. GDP), compared with $1.5 trillion annual total U.S. goods exported globally, and include aircraft ($15.7 billion), soybeans ($12.3 billion) and vehicles ($8.3 billion), among others.

… But economic headwinds could strengthen if a trade war escalates

Although we expect the *direct* economic impact to be muted, further escalation of trade tensions could strengthen the economic headwinds. Late last week, President Trump asked the USTR to explore tariffs on an additional $100 billion of Chinese products in addition to the already-announced $50 billion, citing China's "unfair retaliation" to the recent U.S. actions. We would expect China to again respond in kind if the president makes good on these threats, implying virtually all of the $130 billion in goods that the U.S. exported to China in 2017 would be subject to tariffs.

Part of the outcome will depend on forthcoming measures to limit Chinese investment in the U.S., which the Trump administration is expected to announce in May or early June. These measures could enhance the traditional review process for Chinese transactions under the Committee on Foreign Investment in the United States (CFIUS). But the administration could also invoke the authority of the International Economic Emergency Powers Act, which would give the White House latitude to impose wide-ranging and more draconian restrictions on a broader spectrum of Chinese investments without the strict CFIUS guidelines and timeframes. Depending on the nature of these restrictions and their timing, we could see the Chinese retaliate in a more significant way.

Not a bluff

Since the election, we have made a case for taking President Trump seriously on trade, specifically his desire to rectify what he views as poor trade deals and enforce against unfair trade practices and "bad actors." While some may view the recent U.S. trade actions as symbolic measures intended to bring China to the negotiating table and envision a quick and neat resolution, we tend to expect a more protracted engagement – and potentially heightened trade tensions with China for the balance of 2018 or longer. And while the economic impact of the current trade actions is likely to be relatively minor (and dwarfed by the pro-growth measures passed to date), we would caution that depending on the announcements on Chinese investment in the U.S. and subsequent actions by China, we could see trade tensions escalate, creating stronger headwinds to economic growth.

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