Deal or No Deal – The Trade War Continues

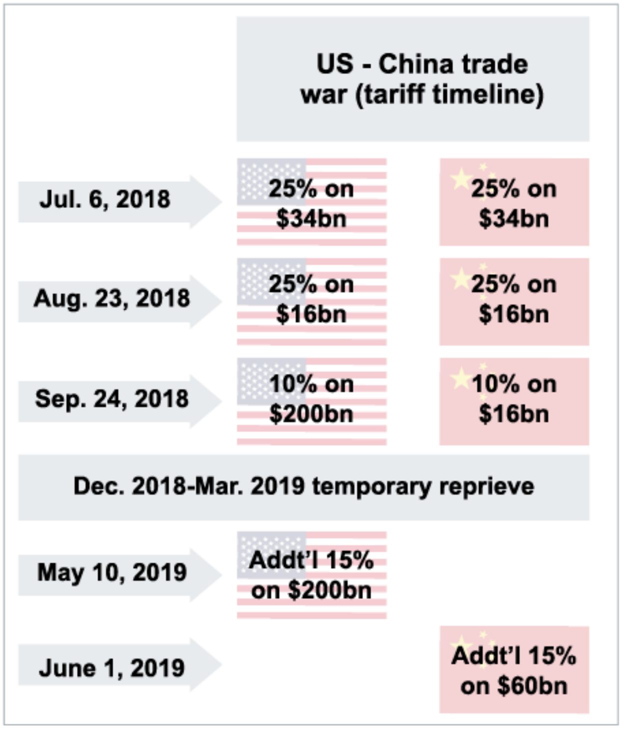
Global Financial Private Capital

Key Takeaways

- Tariffs once again took center stage last week after taking a back seat since the fourth quarter of 2018. Market volatility resurfaced, on concerns of the potential negative impact on the U.S. economy.
- The fallout of the trade war does not appear to be enough, on its own, to push the U.S. economy into a recession to date. However, if the trade war escalates further, investors should be prepared for increased volatility in the global equity markets.
- Since the U.S. economy has held up despite the tariffs, investors may be tempted to underestimate recent headlines. Investors should not be complacent with their portfolios given the strong rally in the markets in 2019 and ensure they have the appropriate safety guards in place.

Trade War Timeline

A full timeline of Trump's trade war with China shows its escalation in four distinct phases. The first two rounds were 25% tariffs on $50 billion in Chinese goods. The third phase was a 10% tariff on $200 billion in additional Chinese goods. In response to these initial stages, China retaliated by imposing 25 percent tariffs on $50 Billion of U.S. exports to China and later tariffs between 5 and 10 percent on about $60 Billion of U.S. exports to China. Most recently, a fourth stage has begun as the administration increased the 10 percent tariffs from stage three to 25 percent. China responded it would raise tariffs, reaching up to 25 percent for most of the goods on its $60 billion list starting June 1, 2019. Finally, the administration has also threatened further escalation, which would impose 25% tariffs on the remaining $300 billion or so of Chinese imports, which would be mostly consumer goods.



Source: Charles Schwab

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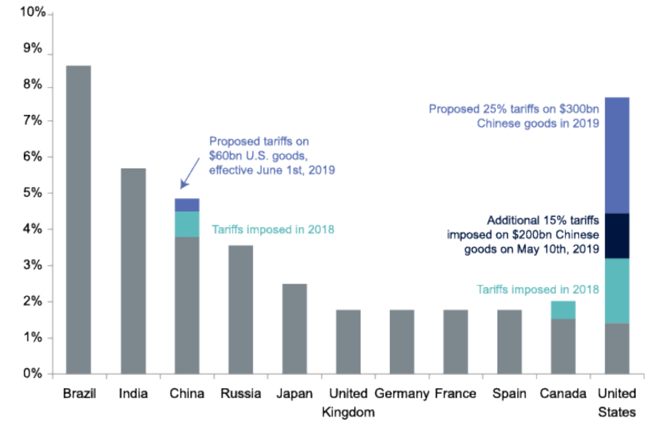
A tariff is a tax on imports. U.S tariff rates are now higher than most developed market economies and competing with those of emerging market economies. According to a study by JPMorgan, the average U.S. tariff rate has risen from a global low of 1.4% in 2017 to a developed market high of 4.5% today. However, if the additional tariffs of 25% on $300 billion goes into effect, the average U.S. tariff rate would increase to 7.7%, in line with countries like India and Brazil.

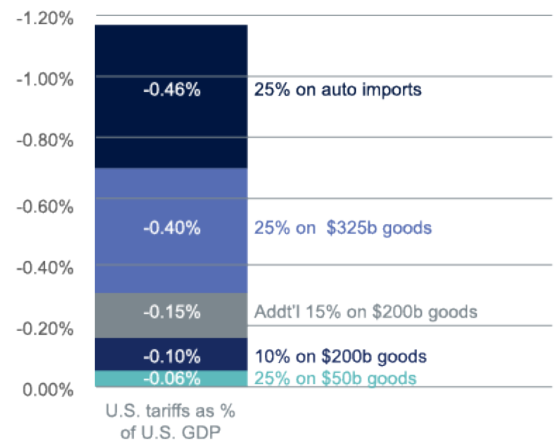


Source: World Bank, J.P. Morgan Asset Management. Historical tariff rates are 2017 figures. Data are as of May 17th, 2019.

Impact on the Economy

The impact of the trade war has been limited in terms of economic growth as measured by gross domestic product (GDP) to date. According to a study by Charles Schwab, the tariffs imposed have cut GDP growth by -0.31 percent. However, if it continues to escalate as currently announced, the impact will be increasingly felt and could cut GDP growth by an additional -0.4 to -0.8 percent.

Economic Impact of Tariffs



Tariff	Value	% of U.S. GDP	Status
Steel & aluminum	$0.76b	0.00%	Imposed
25% on $50b goods	$12.5b	-0.06%	Imposed
10% on $200b goods	$20b	-0.10%	Imposed
Addt'l 15% on $200b goods	$30b	-0.15%	Imposed
25% on $325b goods	$81b	-0.40%	Threatened
25% on auto imports	$90b	-0.45%	Postponed

Source: Charles Schwab, Cornerstone Marco.

What's Next?

Tariffs have impacted some areas of the economy more than others, and a continued escalation in trade tensions could further dampen growth. The fallout of the trade war does not appear to be enough, by itself, to push the U.S. into a recession. U.S. recessionary concerns have declined as fundamentals (employment, retail sales, earnings growth) remain solid and have perhaps even improved over recent months. However, if both sides walk away from the table and the additional tariff goes into effect, it will likely lead to further volatility for global equities. Over time emerging market equities, especially China, will get hurt the most. The U.S. economy has held up much better, thus investors may be tempted to underestimate recent headlines. Investors should not be complacent with their portfolios given the strong rally in markets in 2019 and ensure they have the appropriate safety guards in place if needed. To date, the markets remain optimistic that a deal will be struck.

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