SCB Economic Intelligence Center

Flash by EIC

23 March 2018

U.S. plans to impose tariffs on Chinese imports, raising trade war fear

Event

- On March 22, 2018, President Trump signed the presidential memorandum that instructed the U.S. Trade Representative (USTR) to impose 25% import tariff on USD 60 billion worth of Chinese goods, around 2.5% of total US imports or 11.4% of its total imports from China. The USTR is required to propose a list of import products that are subject to the new tariff within 15 days.

- The memorandum followed an investigation on the violation of intellectual property rights by China which started on August 18, 2017 according to Section 301 of the U.S. Trade Act of 1947. The Chinese authority appeared to display practices and measures that are unreasonable or discriminatory and burden or restrict U.S. commerce. These include 1) restrictions on investment which pressures U.S. companies to transfer technology in exchange for investment in China, 2) discriminatory and unreasonable practices in licensing processes to transfer technologies from U.S. companies to Chinese companies, 3) support by the Chinese authority to direct and facilitate acquisitions of U.S. companies' technology and intellectual property, and 4) cyber intrusion by China into US computer networks to gain access to valuable business insights.

Analysis

- **EIC assesses that tech products top the list of those to be levied taxes.** According to the USTR preliminary report, such list could include aerospace, information and communication technology, and machinery. However, the list of goods will be released in the next few weeks and might contain more products than previously indicated in the report. In EIC's view, technology products such as computers, electronics and electrical appliances also risk being taxed because they showed the largest contribution to the U.S. trade deficit with China of around USD 140 billion in 2017. These goods are also supported by the Chinese government according to its Made in China 2025 policy. Moreover, the second largest contribution to the trade deficit was machinery, furniture and toys. Should only USD 60 billion worth of products be subject to additional tariff as indicated by Trump, just a few categories of imports will be taxed.

- **Beside import tariff, the U.S. will likely issue restriction on Chinese investment.** Trump assigned the Treasury Department to impose measures to control investment from China within 60 days. The measures will aim to deter China's investment and acquisition of U.S. companies which cause technology transfers or obtain the U.S. intellectual properties. The U.S. will likely target industries which earn support from the Chinese government according to its Made in China 2025 policy. The policy seeks to replace foreign products with domestically produced goods which may require certain technology transfers from overseas. These include high-tech products, renewable energy products, medical products and airplane parts.

- **China responded with plans to impose tariff on over 128 U.S. products totaling 3 USD billion.** The plans include a 15% tariff on U.S. steel pipes, fresh fruit, and wine, while pork and recycled aluminum are subject to 25% import duty.

- **EIC views that China could react to the U.S. anti-trade measures through a variety of measures.** These can be classified into 3 options based on the level of tension and magnitude of retaliation. However, they can all trigger the US-China trade war

  1) **China can raise import duty for U.S. products while offer privileges to other trading partners except the U.S.** China currently resorts to product-specific import duty, such as taxes on the U.S. agricultural products, instead of raising the tariff on all U.S. imports across the board. China's response is now only limited to tariff measures. Indeed, the Chinese government may choose to offer trade privileges to other countries who are also adversely affected by the U.S. policy such as the European Union. Such response will form an alliance and relations which can help China negotiates with the US. Moreover, China may also consider limiting privileges given to the U.S., for example, reducing import duty and raising imports from alliance countries but not the U.S. or limiting liberalization of some services sectors including financial, education and health sectors. Those restrictions might put barriers on U.S. companies to reach Chinese consumers.

  2) **To introduce limitations or difficulties for U.S. firms to do business in China, or to slash the number of Chinese tourists visiting the U.S.** An example of U.S. firms in China is General Motors, which has a joint venture there. Although its global sales declined in the last quarter of 2017, but sales in China still posted a positive growth. If tension between the two countries escalates such that the Chinese authorities start to impose limitations on U.S. firms in China, the firms would find themselves in a deeply challenging situation. Similarly, if the Chinese government decides to prevent its people from visiting the U.S., the U.S. businesses especially the tourism industry will take a hit, as several billion USD that Chinese tourists spend each year evaporates. A boycott such as this one has already been used by China against Japan and South Korea. These actions, therefore, are some of the non-tariff measures that the Chinese government has in

its arsenal.

3) **Reduce U.S. treasury holdings.** The Chinese government can retaliate indirectly through the financial market. They can do so by selling USD-denominated assets, especially U.S. treasuries with maturities of longer than 10 years, and invest in government bonds of other allies instead. Such massive sales will hasten the rise in U.S. treasuries yield curve, making it more costly for U.S. government to borrow long-term from the market. According to data from Treasury International Capital (TIC) of U.S. Treasury Department, China holds over 1.18 USD trillion worth of U.S. treasuries in December 2017. Therefore, massive fire sales of treasuries by the Chinese government can cause tremendous volatility in the US treasury market.

- **Concerns among investors about a potential trade war led to massive responses in the financial markets.** Following President Trump's signing of the memorandum and China's reaction that it is ready to retaliate, the U.S. stock market stumbled. The S&P 500 fell 2.5%, the Nasdaq fell 2.4%, and the Dow Jones fell 2.9%. Moreover, the VIX index, which reflects volatility in the financial markets, surged to over 5.5 points, reaching 23.5 points. This morning, the dollar index weakened slightly, while the Japanese yen, considered a safe-haven asset, rose to the strongest level in 17 months.

Implication

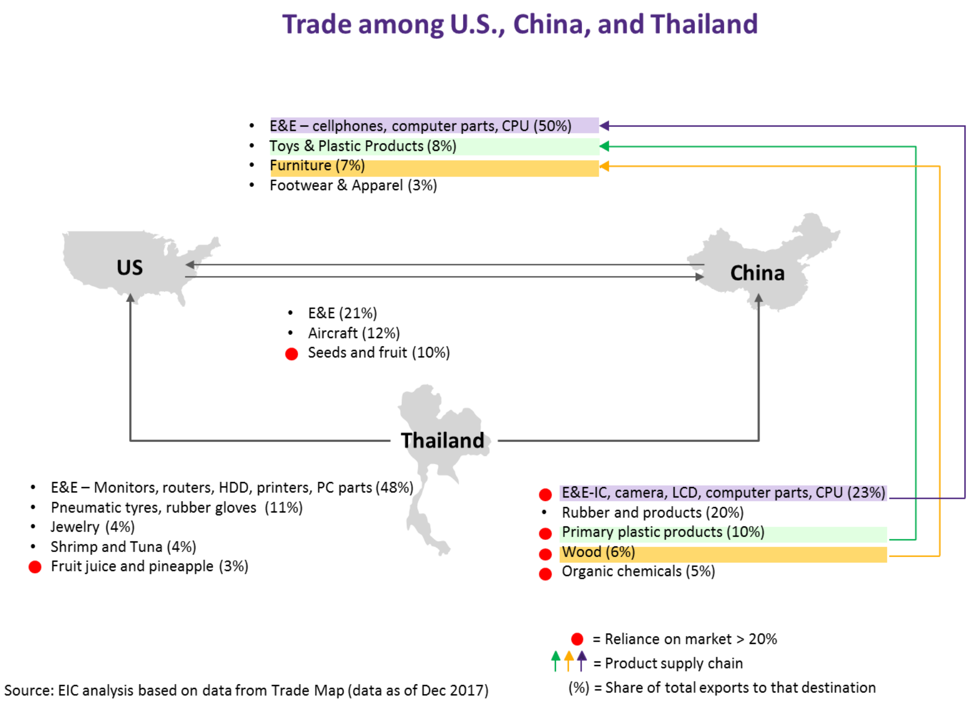
- **EIC believes that the U.S. government's decision to raise import tariffs on Chinese goods has been driven by both economic and political motives.** On the economic side, President Trump hopes to reduce his country's trade deficit with China, which runs the largest trade surplus against the US, totaling 370 USD billion in 2017. Therefore, he is using the allegedly unfair trade practices and the massive size of trade deficits as justifications for a negotiation with China. Meanwhile, his political motives include both external and internal ones. On the internal side, Trump is fulfilling his 2016 presidential campaign promise to charge higher tariffs on Chinese imports. At the same time, he is garnering support from his base ahead of the mid-term election in November 2018. On the external side, this round of tariff talk can be seen as a political warfare between two global powers, as it is directed specifically at China. Indeed, Trump has said that this is only the first among many trade actions coming from him, insisting that he is planning for more. Such a tough stance this time is in contrast to earlier during talks of safeguard tariffs on steel and aluminum, which in the end were temporarily waived for the European Union, Australia, Brazil, Argentina, and South Korea. Therefore, it can be seen that Trump is trying to strike a balance between domestic politics – to maintain his voter base – and international politics, which is to maintain relationships with trade allies like the European Union, Canada, and Mexico. All this is an attempt to put pressure on China through a well-balanced trade and psychological warfare.

- **Thai products that are part of US and China's supply chains could be affected if tariffs are imposed on Chinese goods.** Most vulnerable of all are products exported from Thailand to China as parts, to be manufactured further in China and exported to the US as final goods. EIC finds that products such as these that make up significant shares of Thai exports, and are therefore at risk, are as follow. 1) Electronics, such as industrial circuits, cameras, LCDs, computer parts, and CPU (23% of Thai exports to China, 2) primary plastics (10% of Thai exports to China) that might be used in toys and plastic products that China exports to the U.S. (Figure 1). If tariffs are imposed, China may import less of these goods from Thailand, as their exports to the U.S. decline.

- **However, Thailand stands to benefit from a potential shift in Chinese investment and an increase in exports to the U.S.** Although the detailed list of products subject to the tariffs are not yet available, the White House has indicated that it will try to minimize impacts on U.S. consumers as much as possible. Therefore, it is likely that the U.S. will choose to impose tariffs on the types of Chinese goods that can be substituted by imports from other countries. For this reason, certain Thai products may benefit from higher demand from the US. These include, for example, electronics and electrical appliances, which together account for over 48% of the value of Thai exports to the U.S. In addition, as Chinese goods are the only targets of the new tariffs, Chinese manufacturers may adjust their investment plans by expanding manufacturing capacity to countries outside China. Indeed, Thailand is one of the candidate hosts where Chinese firms can produce and export to the U.S. In the end, this would also lead to higher exports from Thailand to the U.S.

- **EIC will continue to monitor developments regarding details of the tariffs, which may be changed or adjusted to include certain exemptions in the future.** Although the list of products subject to the tariffs will be released by USTR within a few weeks, further adjustments to the list remain possible after that. This is because following the release of the list, the U.S. government is holding a 30-day public consultation period, after which tariff details can be revised according to public comments, before the official measures become effective. During this process, business sectors or consumer groups that will suffer from the measures may call for a change in the product list. Finally, it is still possible for the governments of the two countries to negotiate for less severe trade measures.

Figure 1: Thai products that are part of US and China's supply chains could be affected if tariffs are imposed on Chinese goods



Source: EIC analysis based on data from Trade Map (data as of Dec 2017)

By : Thanapol Srithanpong, Ph.D. (thanapol.srithanpong@scb.co.th)
Yuwanee Ouinong (yuwanee.ouinong@scb.co.th)
Pimnipa Booasang (pimnipa.booasang@scb.co.th)
Economic Intelligence Center (EIC)
Siam Commercial Bank Public Company Limited
EIC Online: www.scbeic.com