On the Minds of Investors

December 2018

Are we on the brink of a global trade war?

What has happened this year?

As shown in **Exhibit 1**, the US and China have been at the epicentre of rising global trade tensions. The US started early in 2018 by imposing tariffs on imports of solar panels, washing machines, and metals. The total dollar amount of these imports was relatively limited. Then, in the summer of 2018 the US began taxing USD 50 billion of Chinese imports, followed in September by the announcement that tariffs would be imposed on a further USD 200 billion of Chinese imports. This additional USD 200bn are currently being taxed at a rate of 10%. This was set to increase to 25% on 1 January 2019, but at the November G20 summit, president Trump agreed to postpone the increase until 1 March 2019 providing some time for negotiations.

China has responded by implementing three waves of retaliatory tariffs on goods imported from the US, although the dollar amount is lower, due to the fact that China imports a much smaller amount of goods from the US than the US imports from China.

At one stage the US was considering raising tariffs on auto imports from the European Union (EU) but plans have been shelved for now. In July, an agreement to work towards lower tariffs and to look at reducing trade barriers was set in motion by the US and EU authorities.

There has been a de-escalation in tensions between the US and its neighbours—Canada and Mexico. The North American Free Trade Agreement (NAFTA) was torn up but has now been salvaged in the form of the United States, Mexico and Canada Agreement (USMCA).

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EXHIBIT 1: TRADE TENSIONS IN 2018

Key: Green = effective, Blue = proposed

US & Rest of world

Date	US action	Details
Feb	Solar panel & washing machines (Section 201) – $10.3bn	15-50% tariff; affecting China & S. Korea
Mar	Steel & aluminium (Section 232) – $38bn	25% tariff on steel; 10% tariff on aluminium; affecting Canada, China, eurozone & Mexico
Sep	Autos and auto parts –$200-300bn	25% tariff; global

US & China

Date	US action	Details
Jun - Aug	$50bn imports from China (Section 301)	25% tariff
Sep	$200bn additional imports from China	10% tariff, due to increase to 25% on 1 March 2019
Sep	$267bn further imports	25% tariff
	China reaction	
Apr	$2.4bn of imports from US	15-25% tariff
Jun - Aug	$50bn of imports from US	25% tariff
Sep	$60bn of imports from US	5-10% tariff, due to increase to 5-25% on 1 March 2019

US & Europe

Date	US action	Details
Mar - Jul	Car imports from Europe – $38bn (Section 232)	20-25% tariff
	Europe reaction	
Mar	Steel & aluminium imports from US – $3.2bn	25% tariff
Mar - Jul	$300bn of imports from US	25% tariff

US, Mexico & Canada

Date	Mexico & Canada reaction	Details
Jun	Mexico: $3bn imports from US	15-25% tariff
Jul	Canada: $12.8bn imports from US	10-25% tariff
	US action	
Oct	Update to NAFTA (USMCA)	Still to be approved by respective governments. Likely to become effective in 2019

Source: China National Bureau of Statistics, European Automobile Manufacturers Association, European Commission, J.P. Morgan Securities Research, Office of the US Trade Representative, US Commerce Department, J.P. Morgan Asset Management. NAFTA is North American Free Trade Agreement. USMCA is US, Mexico, Canada agreement. Section 201 and 301 are sections within the Trade Act of 1974, and Section 232 is a section within the Trade Expansion Act of 1962. Data as of 11 December 2018.

What does this mean for global markets?

The US is a significant trading partner for many economies (**Exhibit 2**, left-hand side). The escalation in trade tensions is one of the reasons why global trade growth has fallen this year from its 2017 peak (**Exhibit 2**, right-hand side). There has been some resilience in emerging market trade growth, which has come from emerging Asian economies, where local consumption growth and growing technology companies are proving more resilient. However, manufacturing purchasing managers' indices in both the developed and emerging world have fallen after the summer, specifically new export orders in China.

There are two immediate market concerns. The first is the extent to which higher tariffs will raise costs in the US and crimp corporate investment. Already corporates' capex intentions have weakened this year, and corporate investment has softened along with it. Companies in the US are citing higher tariffs on their inputs as a reason for lower expected profits in the coming quarters. If the hesitancy on corporate investment is coupled with reduced hiring plans, the implications for broad US economic growth could be serious. Equity investors' nervousness on these considerations have fuelled much of the autumn volatility.

The second is the impact on Chinese growth and any subsequent ramifications for emerging market assets. It seems increasingly apparent, however, that China plans to respond by shoring up domestic growth with additional stimulus. Beijing is starting to increase both monetary and fiscal stimulus, which could prove helpful in limiting the negative implications of tariffs. Infrastructure investment in China is picking up and the reserve requirement ratio has been cut which has significantly reduced SHIBOR. These might just be enough to stabilise China through the tariff tumult in the medium-term, but certainly the near-term activity indicators remain under pressure.

EXHIBIT 2: GLOBAL TRADE

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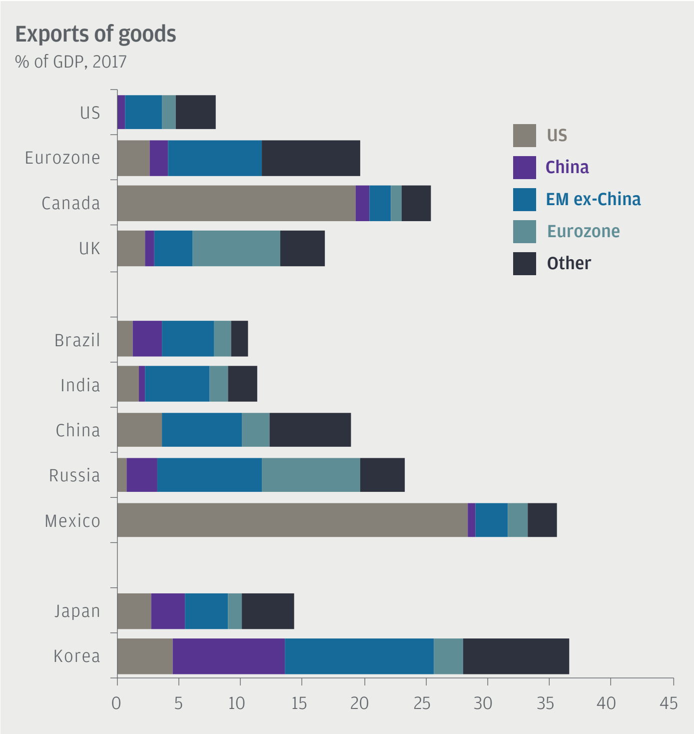

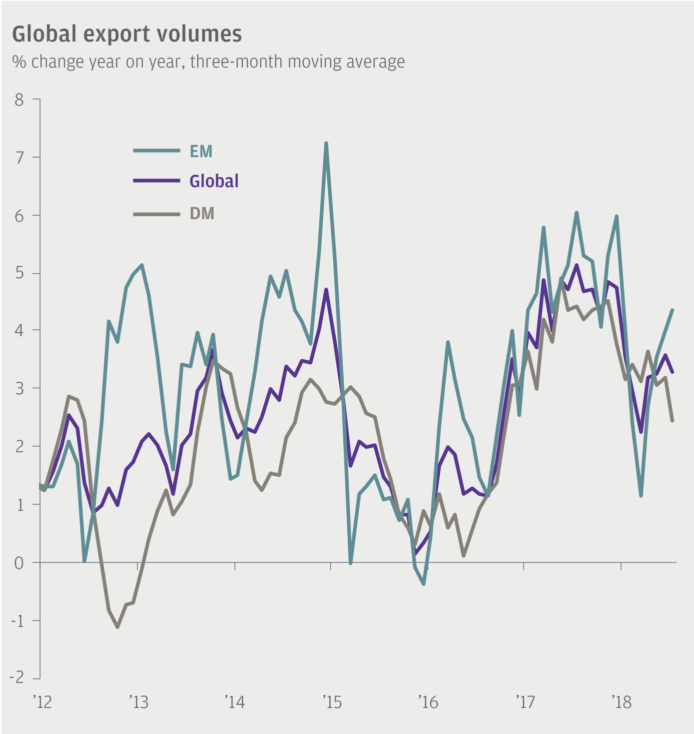

Source: (Left) IMF Direction of Trade, IMF World Economic Outlook, J.P. Morgan Asset Management. (Right) CPB Netherlands, Thomson Reuters Datastream, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Guide to the Markets - UK. Data as of 30 September 2018.

While the November G20 détente between China and the US was helpful for markets, it is possible that the frictions between the US and China could escalate further. Earlier in 2018, the US president did threaten to tax all USD 500 billion of Chinese imports, which would amount to taxes on imports equivalent to roughly 2.5% of US GDP. Such an escalation is likely to have a significant further dampening impact on both the US and Chinese economy.

Over the course of the year we have become significantly more pessimistic that these trade tensions will reach an amicable conclusion. At the root of the problem, both China and the US want to be the dominant global player in tech and there doesn't appear to be much room for compromise. The 'America First' agenda remains politically popular in the US. It is possible that falling equity prices and slowing corporate investment and hiring prompt a rethink in the US Administration. But in the near-term investors may wish to consider a lower absolute level of risk, or a need for insurance and flexibility, in the construction of portfolios.

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