# Is there a trade war coming?

Even though speculation around a trade war with China has been around ever since President Trump won the presidential election in November of 2016, more than a year went by without major news (although President Trump had pulled the US out of the TPP agreement soon after his inauguration). Things started to change in January of this year, when tariffs were announced on washing machines and solar products. On March 1st, the administration announced that steel and aluminum imports would be slapped with tariffs of 25% and 10%, respectively. National security reasons were used to justify the decision. Many countries signaled they would retaliate, amongst them Canada, Mexico, and the European Union. But the biggest development so far came yesterday, March 22nd, when President Trump declared a plan to impose $60 billion worth of annual tariffs on Chinese imports. The reason given was China's alleged appropriation of American intellectual property (both technology and trade secrets). The exact tariffs will be known in the next two weeks. They are supposed to target 1,300 lines of goods, from manufactures to electronics.

Another aspect that has been overlooked is the implementation of measures that will limit Chinese investment in American technological companies. This month the Trump administration already blocked a hostile takeover of Qualcomm, a chip maker, by a Singaporean company. This reflects the concern many people in the government have about Chinese companies (many of them state-sponsored) gaining access to state-of-the-art technology, which could be used to undermine other countries, either economically or militarily.

Finally, the third relevant piece that was revealed yesterday is that a long list of countries (European Union, Argentina, Brazil, South Korea and Australia) will be exempt from the steel and aluminum tariffs that take effect today. These exemptions will result in the top four steel exporters to the US, and four of the top seven aluminum exporters to the US, paying no additional tariffs. This, coupled with the tariffs announced yesterday, reveals that the administration's main concern is China – and not trade in general. In particular, the US is worried about the development of technologically advanced industries in China.

**Consequences**

China announced today (Friday) that it would impose tariffs (15%) on more than 100 American products, whose combined worth is approximately $3 billion in imports. This is almost the same amount that China exported last year in steel and aluminum to the US. Given that the tariffs for those two products came into effect today, the message is very clear. Also, the Chinese government said it would challenge the US tariffs at the World Trade Organization (WTO). More measures may be announced soon, once the details of the new tariffs are known.

We believe China had no choice but to retaliate, even if economic theory predicts that this will affect both sides negatively. China has to think long-term, and signaling that it won't stand still if faced with unilateral actions against its economy is very important. The overall response will probably be proportionate, which will have a double effect: signaling that China is only responding in kind (and would rather not engage in this tit-for-tat game), and, furthermore, avoiding an escalation that could result in more tariffs.

Analyses so far tend to coincide in that the consequences for China will not be major, with its GDP being reduced by 10 or 20 basis points. Two considerations help explain why the damage would be small. First, given the volume of Chinese imports into the US last year (more than $500 billion), the tariffs so far announced do not amount to much (not even 3%). Moreover, China exported $2.3 trillion in 2017, so the tariffs would be hitting less than 3% of them. Second, the list of goods has yet to be announced, so there may end up being some mismatch between rhetoric and reality. There is also a 30-day consultation period that will probably see frantic lobbying from those affected.

There will also be consequences in America, and not only for consumers, who may face higher prices for some goods. China is the third-largest market for US exports. What's more, many American companies that rely on Chinese inputs will see their competitiveness eroded, for they will have to pay more for inputs that will be available more cheaply to firms in other countries.

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