

China: losing patience on US trade protectionism

China has sent a strong message by announcing its own tariffs following the latest US\$60bn tariff plan from Washington. What are the implications?



Source: Shutterstock

The Ministry of Commerce of China has announced imports tariffs of 15% or 25% for a concrete list of items imported from the US.

Nuts and fruits, wine, modified ethanol, American ginseng and steel pipes will all face a 15% import tariff. Pork related items and scrapped aluminium will face a 25% import tariff. These items' export value in total was close to US\$3billion in 2017.

This reply to US trade tariffs sends a strong message to the US, even if the export value is relatively small.

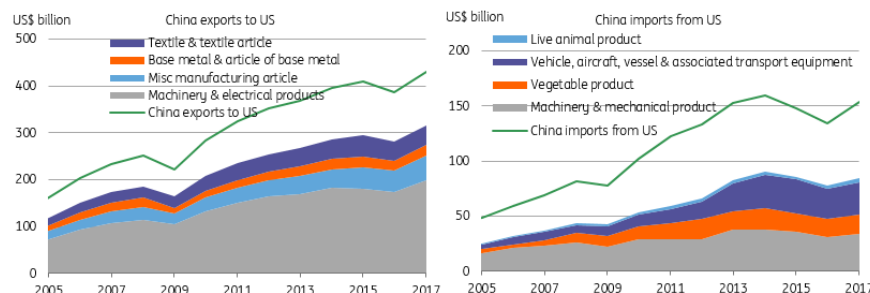
Retaliation is on the cards

Compared to the US plans to put tariffs of US\$60billion of imports from China, the US\$3billion plan in China looks small, but it has big implications.

First, China indicates clearly that it can retaliate.

Second, the retaliation starts with tariffs on major export items namely: vegetable products, pork and scrap metal.

Third, China's embassy in the US has stated that China will fight these tariffs strongly, which implies that the list announced on 23 March may not be exhaustive and could be expanded if the US continues to impose tariffs on China's exports. This could include stopping US companies from operating in China.



Source: ING, CEIC, Bloomberg

A trade war could ensue

Any further reaction by China will depend on what the US does now.

Let's assume the US targets the largest chunk of China exports to the US - machinery and electrical products. Then China could react similarly by imposing tariffs on the largest chunk of US exports to China (either machinery and mechanical products or transport equipment).

We believe that China will choose transport equipment, because if there were import tariffs on China's exports of machinery and electronic products to the US, then those imports from the US would also shrink (there is a complicated two-way supply chain in this sector). Taking this into account, the largest remaining import sector from the US is transport equipment.

Therefore a trade war is more likely to affect China's machinery and electronics sector and the US's transport equipment sector.

Implications are complex

Would Chinese employment be hurt if US companies manufacturing in China decided to move their production lines to locations outside China? Yes. But this is not likely to happen overnight and may be more of a case of considering alternative locations for future Asian expansion.

Additionally, displaced workers could choose other jobs, likely in the service sector that is booming in China and has low skill requirements.

For transport equipment imports into China, there are always substitutes from Europe and elsewhere. So the overall impact on China may be predominantly through rising prices of these substitutes - this is likely to be considerably less than the US tariffs, however. In short, some increase in prices of transport equipment are likely.

Usually there are alternatives

The analysis so far has been on from China-US trade and China-US-World trade, and from manufacturing of machinery and electronics to the service sector in China - there are substitutions

for production location, trade partners and jobs.

If the US imposes restrictions on sectors that require a joint venture, it would also face the consequences of investment decisions made by foreign companies.

There are so many alternatives in a globalized world when it comes to decision-making that we are very likely to have left out something critical in our analysis. And this is the point we would like to make - there are choices.

Even more complicated: Is this economics or politics?

Eventually, we need to ask (or answer) the question, is all this protectionism an economic or a political issue? That would make a significant difference to the outcome. If it is the latter, it could get even more complicated.

And if it looks likely that it is the latter, then the US has helped Taiwan on tourism. China finds this as annoying as US hints that it does not agree on One-China policy.

All in all, trade protection actions imposed by the US may not be too damaging for China. We expect some loss of employment in manufacturing but this may be shifted to the service sector and result in higher prices of some imported goods. The more important point we would like to make is that trade protection actions will lead to changes in global production and trade, given today's globalised, complex supply chain.