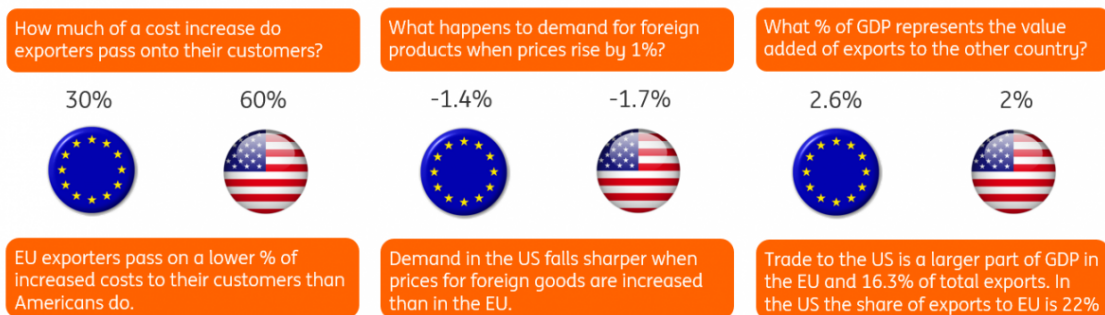
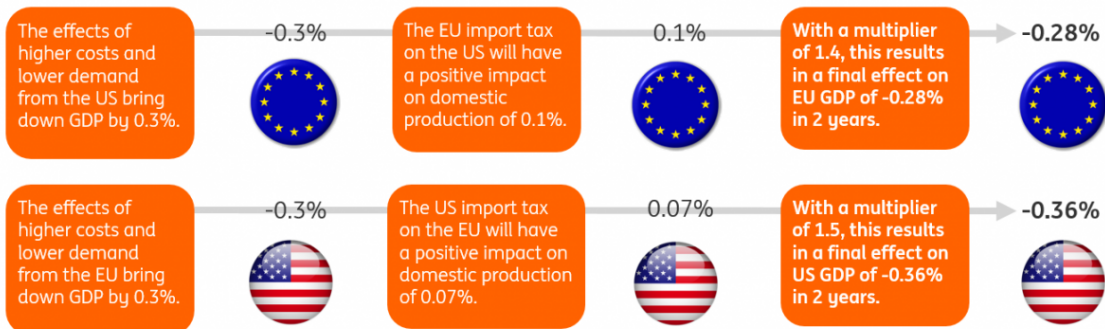


## Trade war: What is it good for?

President Trump is today expected to authorise new tariffs on steel and aluminium imports. While the details remain unclear, global trading partners are already considering retaliatory measures, sparking concern about a full-blown trade war. Here's everything you need to know



That means that growth will be negatively impacted by the import tax as both profits and volumes are hurt. Increased domestic demand for local products because of the levied tax only partly negate those effects.



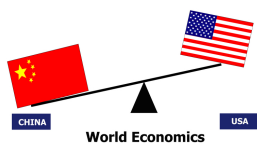
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By Bert Colijn



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The direct impact on China from US steel and aluminium tariffs is likely to be minimal

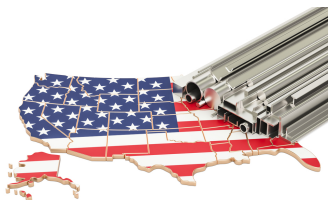
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Base metals suffered losses last week as a slowdown in Chinese manufacturing deflated expectations and the US dollar rose. Although US premiums have...

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## Canada...

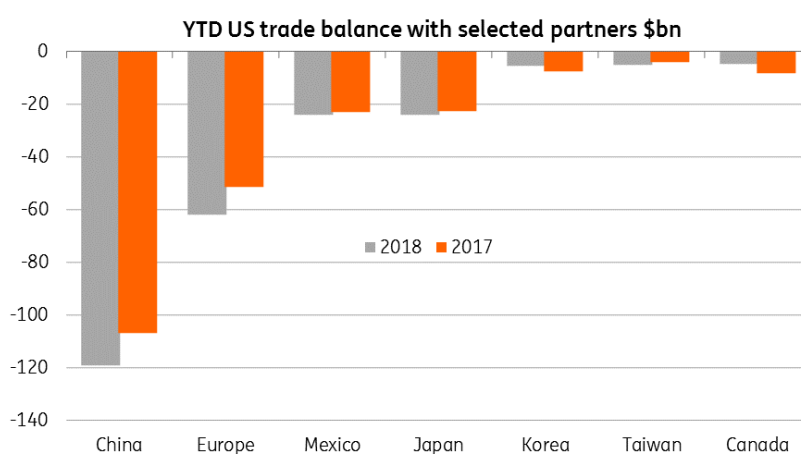
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# A trade war between the EU and US, a lose-lose situation

Trade wars are good and easy to win, according to US President Trump, but higher tariffs lead to few winners and many losers. If the current 'tit...



Tensions between the EU and US have been rising since President Trump announced higher import tariffs on steel and aluminium last Thursday. EU trade commissioner Cecilia Malmström has said that the EU would have to respond and put in place reciprocal tariffs.

The EU has prepared a list of products, if indeed the US were to implement duties, including a 25% tax on a number of steel products, agricultural products and consumer goods. In turn, President Trump said that the US would retaliate by imposing tariffs on European auto sales.

## The domino effect

Assuming the worst, a situation like this could lead to a domino effect resulting in tariffs on the lion's share of all product groups. If we assume that this results in an average tax of 10% on EU exports to the US and the EU levying an additional 10% tax on imports from the US, this will have a negative economic impact on the US economy of -0.4% after two years while the EU will see damage to GDP amounting to -0.3%.

## Everyone loses

Both the EU and the US will see the volume of their bilateral exports decline due to the import taxes. As a percentage of total exports, this loss will be somewhat lower for the EU because companies that export to the US tend to compensate 70% of cost increases (like tariffs) by lowering their profit margins, while US companies do this only for 40%. Lower profit margins add to

the losses incurred by businesses, on top of weaker demand from abroad.

The negative effects on exports are limited, but for both sides, the substitution of imported goods by domestic production is even smaller because both the EU and the US will partly substitute the imports from each other by imports from other countries (we assume that this will be the case for half of the products).

So the overall macroeconomic impact of mutually increased import taxes would be negative, even though limited parts of the economy could stand to gain. While that might be the purpose of the measures, to begin with, the consequences are negative for the overall economy.

This is especially the case for the US as its tariffs are not limited to the EU but global, risking a broader trade war.

## Second round effects

While the impact of the tariffs on GDP through trade may be small, second round effects of tariffs could have significant consequences. Lower profit margins for exporters could impact domestic investments for example. Higher inflation and economic uncertainty would leave central banks in a difficult situation regarding the setting of interest rates. The risk of a broader move towards protectionism has significant economic consequences alone.

As the impact of a trade war reaches well beyond trade volumes, the losers far outnumber the winners.

### Author

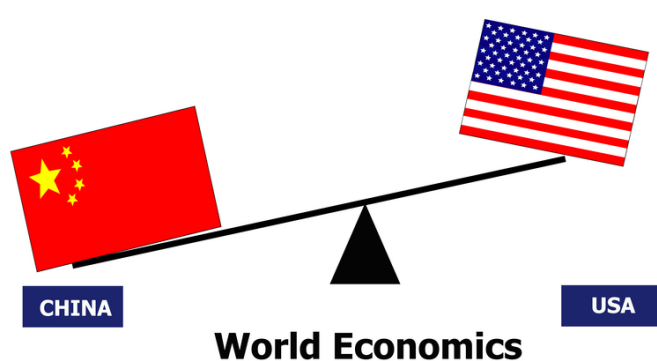
#### **Bert Colijn**

Senior Economist, Eurozone

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## China: Patient on US trade tantrum

The direct impact on China from US steel and aluminium tariffs is likely to be minimal



Source: Shutterstock

### The first round: Little impact on China

The direct impact on China from this first round of US trade tariffs is likely to be small because China has reduced its steel exports significantly, and is not even among the top 10 steel exporters to the US. While China's aluminium exports to the US constitute around 10% of total aluminium exports, the number is still small compared to China's total exports.

To understand why China is not one of the top steel exporters to the US, we need to emphasise that the country has been cutting steel production capacity since 2015. Exports of steel came down from a peak of 11.2 million tonnes in September 2015 to less than five million tonnes in January 2018. In addition, the government has announced further iron and steel production capacity cuts in 2018. That means China would have exported less steel even without US import tariffs.

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*To this extent, US import tariffs don't hurt China's steel producers*

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As for aluminium, China's exports to the US are likely to go somewhere else in the world. As other countries' aluminium exporters would also need to find other buyers, China may end up having more supply domestically, which could mean either Chinese aluminium producers produce less or sell at a lower price or both. So the tariff may hurt some Chinese aluminium exporters but the scale

of aluminium exports is small compared to China's total exports.

All in all, the direct impact on China is minimal.

## The second round: Complicated but China may not be the loser

Some countries will feel the heat from US import tariffs and Europe has already talked about retaliation. Assuming that more countries join Europe, there will be fewer trade flows between the US and the rest of the world.

Would that hurt China? Maybe. When trade flows shrink, US trading partners earn smaller profits, workers earn lower salaries and consumption declines. China's products would also face shrinking export demand. That's likely to be the short-term negative impact on China. But the process may not end there.

Worries about falling profits will lead non-US steel producers to find alternative solutions to boost sales. Producers of final goods that use steel and aluminium in the US would also find other business solutions to avoid the higher cost of steel and aluminium.

These final goods producers could move production from the US to other locations around the world where they could produce at a lower cost, whilst also being closer to their customers, thus allowing them to avoid falling profits. Of course, this would not happen overnight because moving production lines to other countries requires investment and takes time. But this could be an alternative if the US trade wars continue, especially for multinational companies that already have factories outside the US. China, which has a growing consumer market for everything from automobiles to aircraft, could be one such location.

The Chinese government repeated in the 'Two Sessions' (annual meetings for members of the National People's Congress) that China is deregulating its foreign direct investment policies, suggesting that foreigners setting up businesses and factories in China would face fewer hurdles than before.

## If there is a third round...

If the US insists on imposing more trade restrictions on the rest of the world, it is inevitable that world growth will slow. That would hurt China as explained. But we don't think China will just take that as given. We believe that the country will see this as a valuable opportunity to try to bring back world growth.

The Belt and Road Initiative (BRI) could be one of the solutions, or even an expanded version of the BRI, including more countries, which facilitates a trade and investment alliance. By that time, there would likely be even more countries willing to join the BRI.

US trade war? Easy for China.

Article | 5 March 2018

# Metals take a hit but aluminium is clueless on tariffs

Base metals suffered losses last week as a slowdown in Chinese manufacturing deflated expectations and the US dollar rose. Although US premiums have...



Source: Shutterstock

	2018				2019				2020			
	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Aluminium	2,200	2,050	2,150	2,250	2,250	2,150	2,300	2,300	2,200	2,100	2,000	2,000
Copper	7,100	7,000	7,000	6,900	6,900	7,000	7,200	7,200	7,100	7,300	7,500	7,200
Nickel	12,500	12,000	11,800	11,500	11,000	11,500	11,500	12,000	12,000	12,500	12,500	13,000
Zinc	3,400	3,350	3,100	3,050	3,100	3,200	3,000	3,000	2,900	2,800	2,800	2,700
Lead	2,590	2,650	2,600	2,600	2,500	2,400	2,350	2,350	2,300	2,140	2,230	2,130
Iron ore	70	65	65	60	60	55	55	58	60	55	60	65

Source: ING Research

## Aluminium premiums surge on section 232

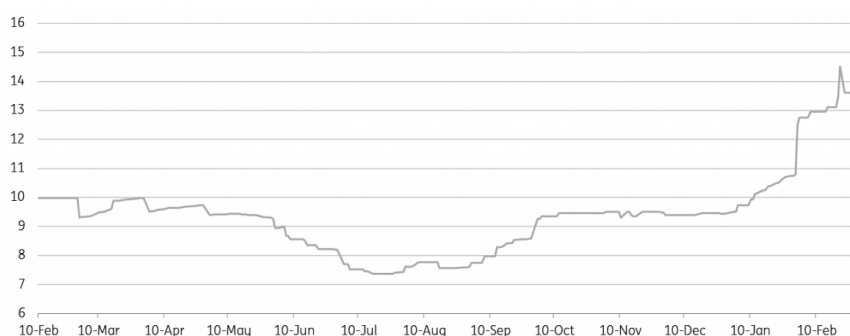
US premiums have surged to 16¢/lb with the CME forward curve pricing in 17¢/lb by the end of the year. On Thursday, President Trump announced he would indeed be imposing a 10% duty on aluminium imports (all types: products and primary). It is worth remembering that prior to the commerce report, the market was largely just expecting duties on fabricated products and perhaps only just those from China. Duties will now clearly be applied more broadly but the all-important details on Canada are still unknown. Canada supplies over 50% of the US imports, with the potential to fill 70%.

Premiums are up 60% year-to-date and whilst a 10% duty supposes around a 10¢/lb premium increase (if Canada is not exempt) it is worth remembering that the market has been pricing in a

duty effect for some time. Still, even if we assume around half of the original 7.7% proposed duty was priced as we crossed 13¢/lb, then premiums still have 3-4¢/lb further to run with 20¢/lb in sight.

As the dust settles in months to come, we could well see US premiums come in from these highs. A near-term sell-off could come if Canada gained an exemption but further out it will be important to track developments in freight rates. A bottleneck in trucking drove much of the earlier increase in the premium with Truckstop data showing Midwest rates are up 31% year-on-year. As new rules on electronic logging become commonplace and capacity is added to trucking fleets, premiums can only ease. We also expect more tight backardations on the LME, which could pressure any customs cleared stockpiles to be sold off into the domestic market. A move which will be all the more tempting at the higher premiums.

## CME premiums pricing 16c/lb for March



Source: CME, ING Research

## Knock on to the LME

Whilst premiums rallied, the LME has traded sideways, with the market seemingly confused as to whether the duties are bullish or bearish for the LME price. We see points on both sides but lean towards a bullish stance at least in the near-term.

- First, it's worth remembering that the LME price is a 'duty unpaid' contract with all registered warehouses in free trade zones. Our near-term bullish view is that traders are already racing to move stocks through customs ahead of the duties. We can already see how the Comex (customs cleared) sheds for aluminium have jumped to 65kt, which is now even greater than LME US stocks. Once the stock is customs cleared it's not coming back. The earnable premium renders it extremely unlikely to be delivered on to exchange. The stock flow from Europe and Asia is already leading to a notch up in global premia, which will support LME prices.
- Next, isolating customs cleared stock from the exchange could set the stage for greater LME tightness which is price supportive.
- We also think trade protectionism is likely to keep more of the Chinese surplus stuck behind its borders. Read: [For once it's not all about China.](#)

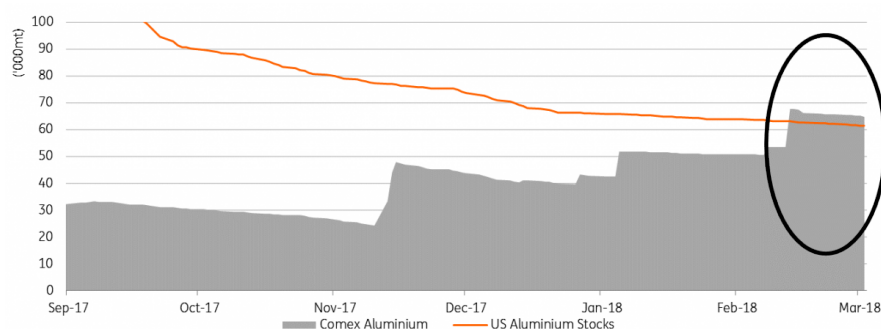
The race to ship stock has been on for a while but now timing will be everything. We have heard it could take up to 60 days to cancel, ship and customs clear stocks from LME Asian sheds which might prove too risky. Mike Bless of Century had estimated 0.5Mt might already be on the move west from both Europe and Asia. Further shipments will likely await more guidance from the White



House but more US free-trade stock is still likely to move.

The bear case is whether high US premiums escalate the unwinding of off-warrant stocks in the US. These could displace imports and loosen the balance outside of the US. We already expected US smelters to begin restarting and forecast a 1.7MT ex-China deficit this year. But this can become a 300kt ex-China & US surplus should an estimated 2Mt off-warrant US stocks offset imports. We can already see that financing profits have been eroded through tighter LME spreads so that high local premiums will prove tempting. We place a lower probability on this right now because financed stocks have proved extremely sticky to date and how much is customs cleared is unknown.

## CME aluminium stocks reflect the rush to customs clear stock



Source: CME, LME, ING Research

## Nickel: Stainless feels the squeeze

Nickel, along with tin, are the only metals that have held on to gains this year but whilst prices are up 24% since December we remain concerned that stainless steel prices in China have barely budged. Producers are failing to pass higher costs on to the consumers who appear well stocked. On Friday, the Shanghai Metals Market reported the first victim, a major stainless steel plant in the south will cut 65% of its 304 series output (2% of China's total). We would reinforce that for all the EV exuberance, batteries are still a minor part of demand (<5%) and stainless clearly drove the market through last year. Stainless output grew 7.5% in the first nine months last year following a 10% surge the year before and is likely to be considerably slower this year.

Nickel is inherently volatile and especially so since the Shanghai Futures Exchange contract opened the door to retail speculators. High volumes and high open interest pushed prices to their recent highs and could yet be vulnerable to liquidation hence our lower forecasts for the year. At the higher prices, the premium in domestic spot markets has been eroded which we take as evidence that the paper markets are inflated. SMM reports Norilsk cathodes now trade at a discount to the SHFE price.

According to media reports, the Philippines will this month look to publish the review of miners' appeal against suspensions for mining in watershed areas. Delays were common when the bans were proposed last year so we will not hold our breath. The Mines and Geosciences Bureau (MGB) reported that 2017 nickel ore production dropped 6% which is close to the drop in Chinese imports but the USGS estimates a far more severe drop of 34%. According to the MGB, 13 out of 30 mines had no output last year so we see room for output to increase. Given the expected rise in domestic Indonesian NPI production (2018F: 260kt) and export permits (now near 27Mt) we think the Philippines developments will take a back seat to market sentiment.

## Stainless yet to pass on higher nickel



Source: Wuxi, LME, ING Research

## Zinc: LME tightness has been exaggerated

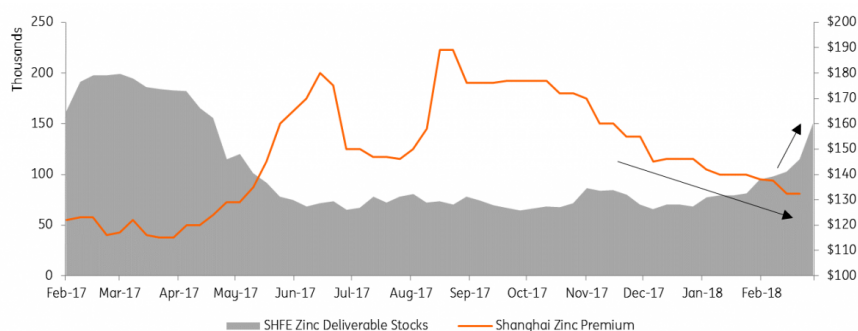
Zinc prices have weakened since Chinese markets re-opened and further evidence showed that markets inside China are considerably less tight than spreads and stocks on the LME had been suggesting. Today's 77kt delivery into the LME and weaker spreads show the tension within the western bourse might be finally letting up.

SMM reported that social/exchange stocks rose a hefty 45kt over the new year and SHFE stocks alone are up another 36kt since. January imports were up three-fold YoY, which clearly ran ahead of demand needs even though they were down 34% on December. Metal Bulletin also reports that premiums in China are down 32% since August and the import arbitrage has been closed since December. Meanwhile, LME stocks have drawn another 38kt through February and the Cash-3M averaged a \$35 backwardation. We think the tightness on the exchange has been somewhat exaggerated since stable western premia suggest supplies are still flowing and today's delivery demonstrates off-warrant stocks remain high. The sell-off last week saw zinc spreads retreat to just a \$3 backwardation which if maintained could encourage fresh shorts.

An easing in concentrate supplies this year forms our view that zinc prices are likely to peak in H1 and tension is high for news of the annual TC/RC benchmarks (treatment and refining charges). The IZA conference in mid-Feb has passed without any deal yet announced. Nyrstar's CEO Hilmar Rode reported that he expects TC's to rise this year as concentrate supply grows but miners are also pushing for big drops since spot rates were so far below the benchmark last year. MB sees spot TC's in China at just \$20/dmt compared to a 2017 benchmark of \$172/dmt.

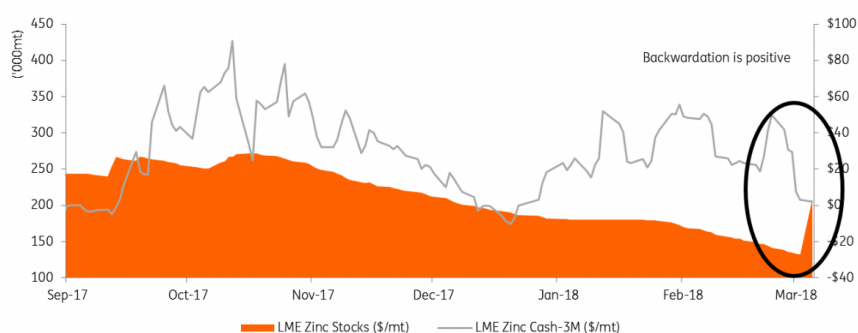
Potentially easing the concentrate tightness near-term, an indefinite strike has been called at Nexa Resources' Cajamarquilla zinc smelter (313kt in 2016), the fifth largest outside of China. The company will act to reduce production losses but 2018 will be a key test for looser concentrates ability to impact refined markets and developments here could prove key to watch. The International Lead & Zinc Study Group has reported the 2017 refined deficit at 495kt and in October forecast a more than 220kt shortage for this year, even as mined output increases by c800kt.

## China zinc market been looking loose for a while



Source: SHFE, MB, ING Research

## LME zinc spreads eased even before the sharp delivery



Source: LME, ING Research

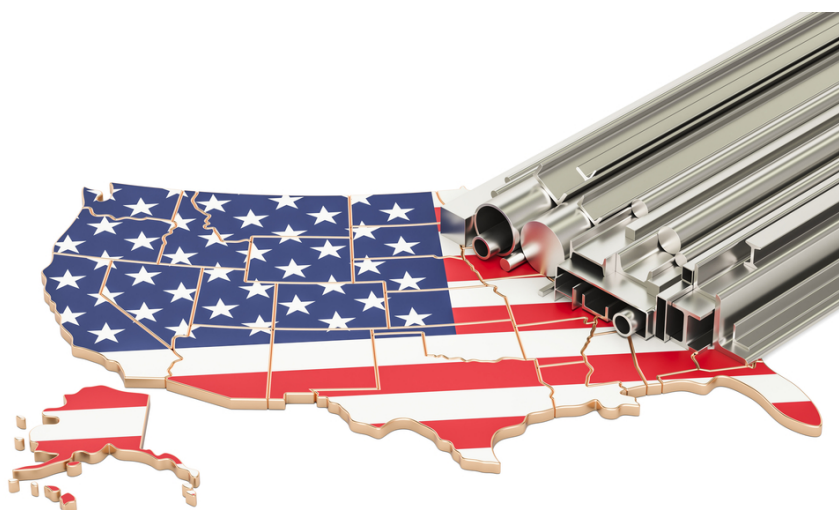
## Lead's discount to zinc hit fresh highs

Lead prices continue to underperform sister metal zinc with the ratio last week coming close to 1.4x for the first time since 2007. Lead prices are down 1.5% year-to-date whilst zinc is still in the green. Looser spreads explain the latest divergence with the lead Cash-3M closing at a \$5.75 contango on Friday compared to a \$7 backwardation just one week before. Driving the shift was a sizeable 22kt increase in LME stocks. Zinc spreads also softened considerably but unlike lead remain in backwardation. Today's LME zinc delivery has seen the ratio fall back to 1.36x.

Chinese lead imports were an insignificant 40kt in January ending the 12 months of volatile imports as SHFE prices are now trading back at a discount to LME. Participants hoping for a pick-up in Chinese activity may yet be disappointed following news that automotive battery producers in Hebei have been required to cut 30% of production as part of pollution controls.

# US import tariffs on steel and aluminium: Who stands to lose?

President Trump's clear intentions to slap import tariffs on steel and aluminium are causing a stir. A global response could have far-reaching impacts...

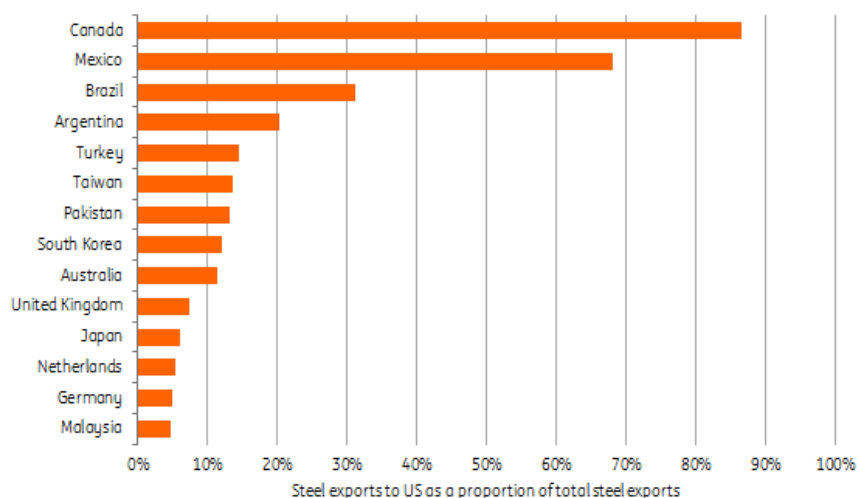


## America First

Donald Trump's announcement of 25% US import tariffs on steel and 10% on aluminium came earlier than expected, but the latest development in US trade policy is not surprising, following the US exit of the TPP trade agreement and re-negotiation of NAFTA, other policy changes with roots in the protectionist logic of America First.

The tariffs, which have been presented as measures to support domestic industries, are broadly in line with the recommendations made in a [report](#) published in February by the US Department of Commerce which found that “the quantities and circumstances” of US imports of aluminium and steel “threaten to impair the national security”. President Trump has chosen to implement tariffs on US imports from all countries, rather than a quota, or a combination of a quota and tariffs for selected countries, and go higher than the report's recommended tariffs on imports from all countries (24% for steel and 7.7% for aluminium).

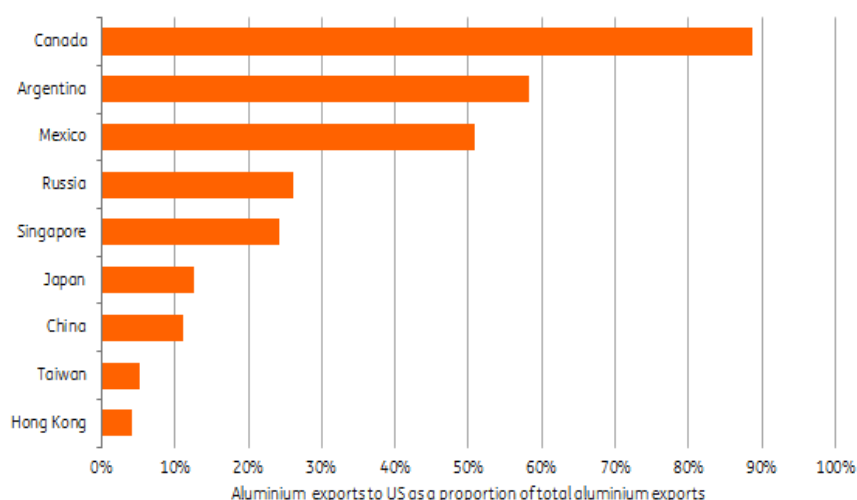
## US is a significant destination for steel exports from Canada, Mexico, Brazil and Argentina



## Steel and aluminium export flows

Tariff increases should not apply where existing free trade deals are in place. But the announcement raises the already-high stakes in the ongoing renegotiation of the NAFTA trade agreement, as Canada and Mexico send high proportions of their total steel and aluminium exports to the US. The US was the destination for 86% of Canada's steel exports by value in 2016, and 88% of its aluminium exports. Just over 50% of Mexico's aluminium exports were to the US. Argentina and Brazil, which are not protected by a free trade agreement, send high proportions of their steel exports to the US, and the US is also an important destination for Argentinian aluminium exports. Just over 10% of China's aluminium exports go to the US.

## The US is also an important destination for aluminium exports from several countries



## New phase for world trade

While the US is an important destination for some countries' steel and aluminium exports, these trade flows represent a small fraction of these countries' total exports of all products, and by extension, world trade. Steel and aluminium exports to the US accounted for less than 1% of world exports of all products by value in 2016 (they were 3% of Canada's total exports and less than 1% of China's).

The significance of these tariffs will be partly determined by the responses of other nations. By raising tariffs on the imports from all countries, the US has invited reciprocal measures from a much wider set of trading partners than have yet been affected by the US exit from TPP, or re-negotiation of NAFTA. So even though the flows affected by higher tariffs are small in terms of world trade, a much greater set of countries will now be considering defensive responses, bringing world trade into a phase of more trade-restricting policy responses.

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