

China hits back with surprise tariffs

China has eventually retaliated with tariffs but this retaliation is far from the last. Very soon, we expect American companies to be included in China's "unreliable entity list". If the trade talks in September don't make much progress, we think USD/CNY to move closer to 7.10 level or even cross 7.10 briefly



Source: Shutterstock

An unexpected Friday afternoon retaliation

China has just announced it will impose 5% to 10% tariffs on \$75 billion of goods (including frozen pork and nuts) along with resuming the 25% duty on US automobiles and auto parts from 15th December. Some tariffs will come into effect on 1 September while others will kick in around 15 December.

What's interesting to note here is that the market was not expecting this tariff retaliation given that China did not immediately react to the 10% US tariffs on \$300 billion goods and President Trump's unexpected tariff delays to 15 December.

But even though China's tariffs are smaller than what the US has imposed, the sudden surprise element of it all should cause a risk-off to asset markets globally.

But there will be more

But tariffs aren't the only tool China has to retaliate against President Trump's tariffs.

China has said a few times that it has its own 'unreliable entity list' ready. The market has speculated that the first company to be included in that list is likely to be American, and we think that's when the war of 'entity list' will kick-off. This will be another risk-off factor for asset markets.

Yuan could be weaker

As China has allowed USD/CNY to cross 7.0, we think it is possible that this tactic is reused to weaken the yuan further to surprise the market again.

We expect USD/CNY to move closer to 7.10 level or even cross 7.10 briefly if the trade talks in September don't make any progress like the last round.

Over to the US

The unanticipated Chinese move to impose more tariffs on the US has caught the market off guard and has put the Trump administration in a position who is likely to retaliate but in an unprepared way.

If the US retaliates harshly, then we expect China to really kick off its unreliable entity list. But if it doesn't, it will be on the back foot during the upcoming trade negotiations in September - and given President Trump's latest tweets, that seems improbable.

In our view, one thing is for certain, this is a lose-lose situation for both China and the US in this trade and technology war.

Author

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com