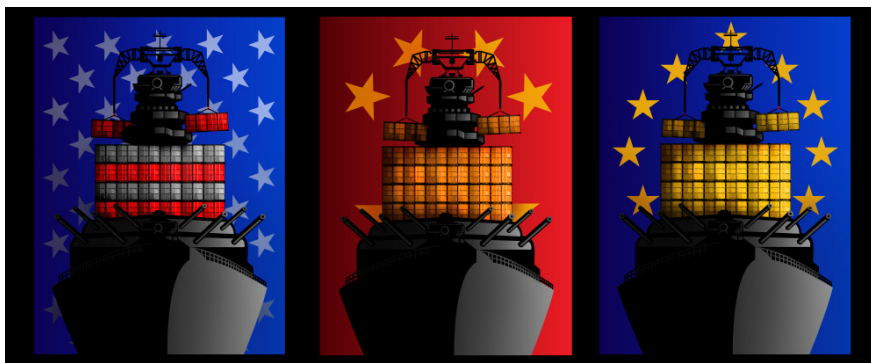


How will China retaliate against higher tariffs?

China is facing a new round of 10% tariffs on \$300 billion of goods exported to the US to be effective on 1st September. How China retaliates will determine the tariffs' impact on both economies



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US raises tariffs on China

The US is to levy a further 10% of tariffs on the remaining \$300 billion of goods it imports from China. The tariff will become effective on 1st September. This escalation of the trade war comes hot on the heels of trade talks that ended with no progress on 31st July after only half a day of discussions, but which were described as "constructive" by Director of the US National Trade Council, Peter Navarro.

How will China retaliate and impacts on the trade war?

There are a few things that China can and probably will do in retaliation to the US' new round of tariffs:

1. **Announce China's unreliable entity list.** This could exclude some US companies from doing business with Chinese companies. The unreliable entity list is said to be announced soon. The market has been guessing which US companies will be the first to be included in the list, and thereby shut out from doing business with China.
2. **Prohibit exporting "rare-earth" materials to US** and related companies that use them in the production of US products (very important in a lot of hi-tech/electronic products). This could halt, or at least slow some US production.
3. **Increase tariffs on US goods.** Though China imports far less from the US than the US

imports from China, China could still raise tariff rates further - conceivably beyond 25%. China already raised tariffs from 10% to 25% on \$60 billion of US goods on 1st June.

These possible sources of retaliation from China would, of course, escalate the trade war further.

Impact of US tariffs and China retaliation on the Chinese economy

For the 10% tariffs on the rest of the \$300 billion goods imported from China, this involves electronic devices.

The 10% tariffs on \$300 billion goods will hurt some US tech product companies, which have so far been shielded from the tariffs. US companies could conceivably shift value chains away from China in an attempt to limit the blow of tariffs on their margins. Over the medium term, this is certainly possible, but in the short-run, this is unlikely to be practical given the highly specialized nature of some of these products.

Rare earth export embargoes will heap further pressure on US tech companies. Though they may have some inventories of rare earths, these probably won't last long. Alternative sources of rare earth materials are being developed to try to lessen dependence on China which is currently the source for 80% of global rare earth supply. But this will also take time. In the short run, the alternatives are either paying a much higher price to gain access to rare earth supplies or going without altogether.

Impact of possible China tariffs

The impact on China of imposing higher tariffs on the US is similar to the impact on the US of raising tariffs on China. Both actions weigh on margins, turnover and the profitability of domestic industry. One way to alleviate the damage from tariffs would be to import more from other economies. Europe is a likely option (for both the US and China) but we expect that this will not work for all goods, and supply constraints may also limit the degree to which this will be possible.

In short, China's importers, producers and consumers of US imported goods will pay higher prices in the future unless alternatives are found.

Using all the retaliation methods

We expect China to use all the retaliation methods described above, but not all at once. We believe China will deliver each retaliation methodically, and deliberately, one by one.

We believe China's strategy in this trade war escalation will be to slow down the pace of negotiation and tit-for-tat retaliation. This could lengthen the process of retaliation until the upcoming US Presidential Election. It won't have escaped the authorities in China's attention that a full-blown trade war is unlikely to help President Trump's chances in the election.

Is this election interference? Well as they say, all's fair in love and (trade) war.

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