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Trump escalates trade war against China

US President Trump has taken the US trade war against China to a new level with his decision yesterday to impose a 10 percent tariff on an additional \$300 billion worth of goods, effective September 1, coupled with a warning that it could go much higher.

The new tariff is in addition to the 25 percent tariff already in place on \$250 billion worth of goods and its impact will be significant because it covers a wide range of consumer products not previously subject to levies. The decision means that essentially all Chinese imports into the US are now subject to a tariff.

Announcing the decision in a series of Twitter posts, Trump said China had “agreed to buy agricultural products from the US in large quantities, but did not do so.” Additionally, he said China had agreed to stop the sale of Fentanyl, a synthetic opioid, to the US but this “never happened.”

Trump described the tariff as a “small additional levy” but later indicated that it could increase in stages and may go “well beyond” 25 percent in the future. While the new tariff rate is less than those imposed so far, it represents the most significant escalation of the more than year-long trade war because previous measures were largely confined to industrial products.

The new measures will cover products ranging from smartphones, clothing, toys and a range of other consumer goods. The only products to be excluded will be select categories, including medical supplies.

The decision brought an immediate reaction on Wall Street as markets took a dive.

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Earlier in the day they had risen, following a sharp fall on Wednesday on the back of remarks by Fed chairman Jerome Powell that the Fed's reduction of interest rates by 0.25 percentage points was not the start of a series of reductions. But they started to rise when trading began yesterday on the belief that September would bring a further rate cut.

But the tariff announcement brought a sharp reversal, with the Dow finishing down by 280 points, a swing of almost 600 points in the course of the day. The S&P 500 fell by 0.9 percent and the tech-heavy Nasdaq index lost 0.8 percent. In another indication of market sentiment, the yield on the benchmark 10-year US Treasury bond dropped to below 2 percent, to reach its lowest level for the year.

Trump said he was "not concerned at all" above the negative response in the markets. In a kind of perverse logic, he may even welcome it because the financial instability feeds into his push to have the Fed further cut rates to boost the markets. In his presentation of the decision by the Fed to cut rates on Wednesday, Powell cited "trade tensions" on multiple occasions as one of the key reasons for the rate-cut decision.

The decision to escalate the trade war came after a report back to the White House on discussions in Shanghai on Tuesday and Wednesday involving US Trade Representative Robert Lighthizer and Treasury Secretary Steven Mnuchin.

The talks, preceded by an outburst from Trump that China was continuing to "rip off" the US, were almost perfunctory—a working dinner on Tuesday night followed by talks lasting just a few hours on Wednesday before the US delegation returned to Washington. Both sides issued statements saying the discussions had been "constructive" but the only agreement was to hold further high-level talks in September.

Significantly, the US side said those discussions would involve an "enforcement mechanism" for any trade deal but this was not mentioned by the Chinese side. This has been a key sticking point in the negotiations because of the US insistence that tariffs should remain in place until Washington unilaterally decides that China is complying with any deal—a position rejected by Beijing as "unequal" treatment.

Whether further discussions will take place in Washington is a now moot point, with Beijing, as of this writing, yet to give its response to Trump's latest measures. But China will most likely agree to take part, not wanting to be seen as initiating a total breakdown. Following Trump's escalation of tariffs in May from 10 percent to 25 percent on \$200 billion worth of goods, Beijing decided it would attend Washington talks, after a discussion in ruling circles.

Administration officials indicated they expected the talks to go ahead. In what could be construed as an attempt at black humour, Trump tweeted: “We look forward to continuing our positive dialogue with China on a comprehensive trade deal, and feel that the future between our two countries will be a very bright one!”

In comments to reporters, he said: “If they don’t want to trade with us anymore, that would be fine with me. Until such time as there is a deal, we’ll be taxing them.”

The impact of the tariffs will in fact fall either on the US consumers or the firms importing Chinese goods, which will have to decide whether to pass on the levy or try to absorb it. The latest tariff brought an adverse reaction from US business circles.

The head of international affairs at the US Chamber of Commerce, Myron Brilliant, said: “Raising tariffs by 10 percent on an additional \$300 billion worth of imports from China will only inflict greater pain on American businesses, farmers, workers and consumers, and undermine an otherwise strong US economy.”

The trade war escalation will also have a longer-term effects as it impacts on business confidence and investment decisions, particularly in manufacturing. According to data from the Fed, industrial production was down by 1.9 percent annually in the first quarter of the year and dropped by 1.2 percent annually on the second. The fall in manufacturing was down even further, falling by 1.9 percent and 2.2 percent in the two quarters, respectively.

The downturn, fuelled by trade tensions and weakening global growth, is continuing. The Institute for Supply Management said yesterday that US manufacturing was at its lowest level since August 2016 and had declined since June. The escalation of the trade war can only intensify this trend, notwithstanding Trump’s assertions that the “strong” US economy gives it an advantage over China.

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