

## Flash Note 15/03/2018

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### Trade tensions - As things stand today and ... as we see it.

After having read and listened to everything related to the growing commercial tensions, I lean to believe that we are going to see a lot more protectionist theatrics coming out of the White House.

In fact Trump is seeking to impose tariffs on up to \$60B of Chinese imports and will target the technology and telecommunications sectors. According to a Reuters report, a source with direct knowledge of the administration's thinking suggested yesterday that the tariffs could come "in the very near future" and also raised the possibility of targeting a much broader range of products.

- **The case for calm is easy to state**
  1. Trade deals rarely determine trade balances, with individual tariff hikes having historically little economic impact.
  2. Most key prices have behaved as if nothing had happened: The dollar didn't tank (being now fixed at 1.236), and Treasury yields didn't move much –currently at 2.83%– .
  3. Metals tariffs was quite a bit tamer than the original threat, with automatic carve-outs for Canada and Mexico, and the potential for other friendly nations to apply for exemptions.
  4. Beijing's stance: Chinese authorities are looking to maintain a strategic composure over President Trump's trade moves. Nevertheless, Beijing has warned that its response on Taiwan would be another matter: "If Trump plays the Taiwan card, China could take a strong stand". (Bloomberg 14th March)
  
- **Looking out on a longer time horizon, however, there are issues that are worth vigilant attention:**
  1. The resignation of economic advisor Gary Cohn and the apparent ascendancy of the trade warrior faction (P.Navarro & Lughthizer) and the national security team (Mc.Master & Mattis), and ...
  2. The upcoming midterm Congressional elections, make it almost certain that we will see a further barrage of trade actions.
  3. The main enacted policy (bigger deficits) will lead to a wider trade deficit, which will probably generate more frustration on Trump's economic team. Temptation will be to launch even more protectionist measures.

- **Is this just noise before the Midterm elections or is it something more serious?**

Indeed, the US trade actions might just be more noise (before the Midterm elections). One of the main events that will help us to clarify whether we are attending the configuration of a commercial conflict on a global scale, will be the renegotiation of Nafta.

After discussing this issue in depth with my team in Mexico, a more likely case is that Nafta renegotiation drags on inconclusively this year and is kicked into next year. This situation would then leave things right as they are, with little reasons to panic.

A more dire possibility (though less likely in our view), is that after months of inconclusive haggling, Trump formally withdraws from Nafta ahead of the midterm elections.

Why we consider this second scenario as unlikely? Simple. This could lead to a fair amount of chaos in North American production chains, and the economic effects could be material. Certainly, an environment that Trump will want to avoid at all costs in a year in which his policy mix seems quite fragile.

- **China faces challenge in reducing US trade surplus.**

China faces an uphill climb to cut its trade deficit with the US by \$100B, a key obstacle being that its current account surplus has already fallen to 2.4% of GDP from 9.9% in 2007. Exports remain a key source of employment and Beijing may be reluctant to clamp down on shipments.

Best regards