



► SPECTRE OF TRADE WARS RATTLES MARKETS

The US administration's decision to slap trade tariffs on USD50bn worth of Chinese imports has rattled financial markets. The move to introduce tariffs should not come as a surprise given that one of President Trump's key campaign promises was to correct US' trade deficit, with China being a key perpetrator.

We have seen China's preliminary reaction; firstly, in our opinion the tariffs are aligned with the previous tariffs on steel and aluminum and secondly the petition to World Trade Organisation ("WTO") suggests restraint and consensus building.

Thus far, investors have become nervous about possible escalation, triggering market volatility in the near-term. Longer-term, however, the wider implications of a "tit-for-tat" trade war and its knock on effect to the global value chain are legitimate concerns.

US TARIFF JUSTIFICATION

A 2011 report published by the US International Trade Commission argued that China uses a range of practices to force companies to transfer intellectual property ("IP") and that Chinese entities engage in theft (according to President Trump) of US trade secrets to become a leader in advanced



Colin Graham

Chief Investment Officer –
Multi Asset Solutions
Eastspring Investments



Rong Ren Goh

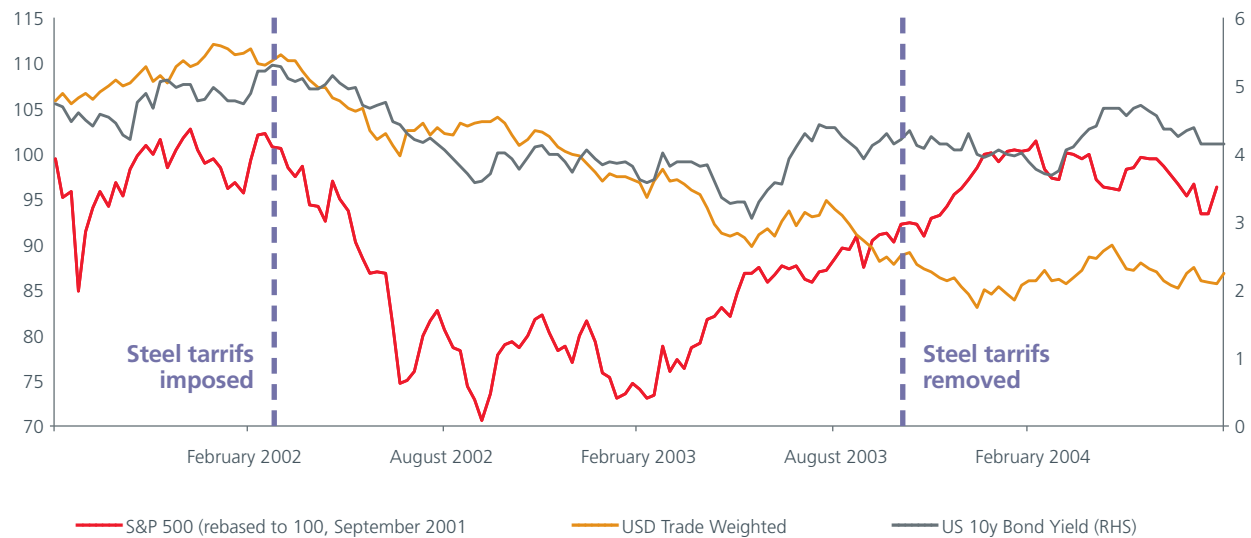
Senior Manager –
Fixed Income
Eastspring Investments

manufacturing and artificial intelligence. The report also stated that if China matched US levels of IP protection, it would likely create 923,000 US jobs and increase US exports and affiliated sales to China by approximately USD107bn per year.

US businesses in China have long complained about being forced to hand over technology as the price of gaining access to the market. The US administration has also criticised the generous support given to Chinese state owned enterprises, arguing for the implementation of more market reforms, including the opening up of sectors of the economy to more foreign investment.



Fig.1: US equities and yields took a hit the last time steel tariffs were imposed¹



POSSIBLE OUTCOMES FROM THE 301 FINDINGS

In Aug 2017, the US Trade Department - under President Trump's instructions - formally initiated an investigation on China under Section 301 of the Trade Act of 1974 to determine whether acts, policies, and practices of the Chinese government related to technology transfer, intellectual property, and innovation unfairly discriminated against or burdened US trade. The findings will likely be released in April and possibly activate:

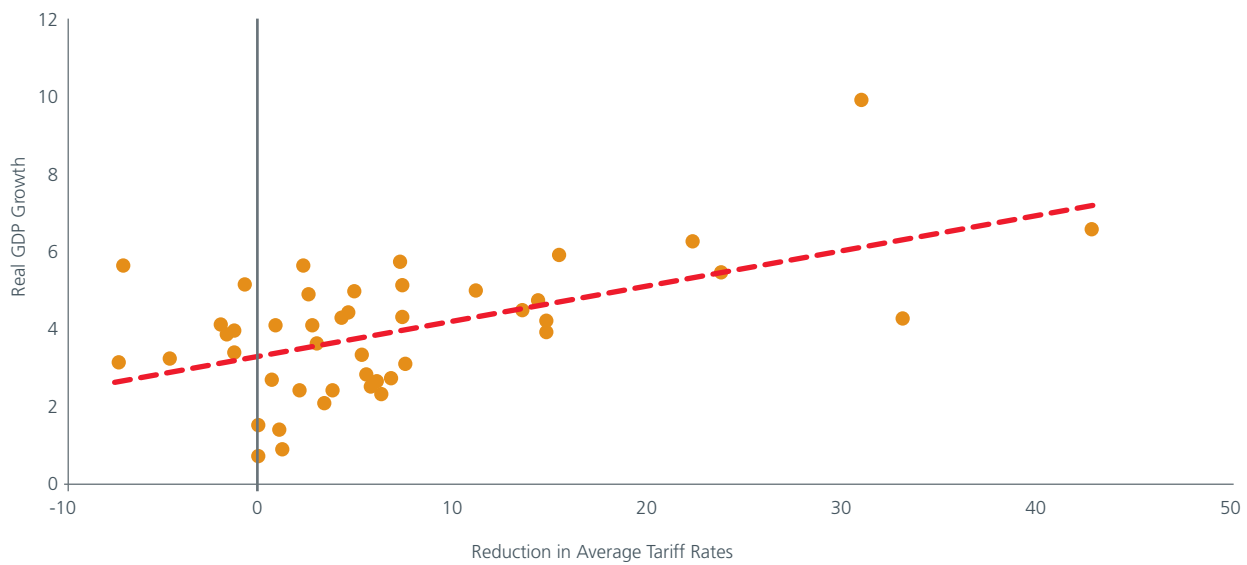
1. Tariffs and quotas against a range of Chinese products in the high tech sector; the obvious targets include telecom, computer and other electronic equipment which account for approximately half of the bilateral deficit.
2. Restrictions on China's foreign investment in certain sectors of the US economy; Broadcom's blocked bid for Qualcomm is already one such example.
3. Restrictions on US visas granted to Chinese individuals, including student visas.

DIRECT AND INDIRECT IMPACT OF TARIFFS

The direct macroeconomic impact on China is likely to be modest initially as the proposed USD50bn is roughly 10% of US imports from China. A UBS research estimates that a 10% tariff on all Chinese exports will only shave 0.3-0.4 points off China's GDP growth; the caveat being the largest sector (telco equip/phones) has very little domestic value add as the factories assemble the parts for re-export. China also has a well-diversified export market and does substantial trade with Asia, Europe and Japan.

Within Asia, however, Korea and Taiwan (linked to China supply chain) will likely be negatively impacted by the US tariff move, while Malaysia and the Philippines (China competitors) may see a net benefit. Any trade war, however, will likely hit emerging markets ("EM") as its growth is closely linked to global trade volumes. A forceful application of protectionism would harm international trade volumes and impact overall EM economic growth, which has far outpaced developed market growth over the past 2 decades.

Fig.2: Changes in Average Tariff and Annual GDP Growth, 1990-2015²



The indirect impact is harder to quantify and ultimately could prove more influential. An actual trade war would also have a secondary impact on financial markets, undermine business and consumer confidence. US sectors sensitive to trade retaliation, such as agriculture and aircraft production, would likely be affected. The denial of access for US companies to key growth markets in China will pose another significant headwind. The impact of US economic growth is undeniably negative in such a scenario - it's merely a question of how much. From a US perspective, any counter tariffs from China will have minimal effect on exports. Many of the US high tech industries are already protected by policy directives; selected US companies are banned from exporting to China.

OUR TAKE

We do not expect an immediate implementation of the tariffs as US industry could be petitioned. The goal will be to sound tough on trade but minimise the impact on US consumer. Other announcements by President Trump have either been rolled back or watered down. The end game, from the US

perspective, is designed to move negotiations and extract economic concessions from China at a faster pace, and ultimately reduce the US-China trade imbalance by USD100bn.

It is also unclear whether the Trump administration intends to move against China without first going to the WTO. It could argue that its concerns about China's IP policies and practices do not involve a WTO trade agreement and that the 1974 Trade Act empowers the US President to respond to a foreign country's unfair trade practices. Still, such unilateral approaches are not in US' favour; a significant trade war would destabilise global equity markets and impair the Trump administration's "market scorecard". We should note that depending on which goods China, Europe and Japan intend to raise import taxes, this may erode Trump's support base ahead of the US mid-term elections in November.

Risks of a full-blown trade war remain contained for now. Longer term the imposition of trade barriers and restricted information/people movement will increase friction, which could change the trajectory of global growth.

Disclaimer

This document is produced by Eastspring Investments (Singapore) Limited and issued in:

Singapore and Australia (for wholesale clients only) by Eastspring Investments (Singapore) Limited (UEN: 199407631H), which is incorporated in Singapore, is exempt from the requirement to hold an Australian financial services licence and is licensed and regulated by the Monetary Authority of Singapore under Singapore laws which differ from Australian laws.

Hong Kong by Eastspring Investments (Hong Kong) Limited and has not been reviewed by the Securities and Futures Commission of Hong Kong.

Indonesia by PT Eastspring Investments Indonesia, an investment manager that is licensed, registered and supervised by the Indonesia Financial Services Authority (OJK).

Malaysia by Eastspring Investments Berhad (531241-U).

United States of America (for institutional clients only) by Eastspring Investments (Singapore) Limited (UEN: 199407631H), which is incorporated in Singapore and is registered with the U.S Securities and Exchange Commission as a registered investment adviser.

European Economic Area (for professional clients only) and Switzerland (for qualified investors only) by Eastspring Investments (Luxembourg) S.A., 26, Boulevard Royal, 2449 Luxembourg, Grand-Duchy of Luxembourg, registered with the Registre de Commerce et des Sociétés (Luxembourg), Register No B 173737.

United Kingdom (for professional clients only) by Eastspring Investments (Luxembourg) S.A. - UK Branch, 125 Old Broad Street, London EC2N 1AR.

Chile (for institutional clients only) by Eastspring Investments (Singapore) Limited (UEN: 199407631H), which is incorporated in Singapore and is licensed and regulated by the Monetary Authority of Singapore under Singapore laws which differ from Chilean laws.

The afore-mentioned entities are hereinafter collectively referred to as **Eastspring Investments**.

The views and opinions contained herein are those of the author on this page, and may not necessarily represent views expressed or reflected in other Eastspring Investments' communications. This document is solely for information purposes and does not have any regard to the specific investment objective, financial situation and/or particular needs of any specific persons who may receive this document. This document is not intended as an offer, a solicitation of offer or a recommendation, to deal in shares of securities or any financial instruments. It may not be published, circulated, reproduced or distributed without the prior written consent of Eastspring Investments. Reliance upon information in this posting is at the sole discretion of the reader. Please consult your own professional adviser before investing.

Investment involves risk. Past performance and the predictions, projections, or forecasts on the economy, securities markets or the economic trends of the markets are not necessarily indicative of the future or likely performance of Eastspring Investments or any of the funds managed by Eastspring Investments.

Information herein is believed to be reliable at time of publication. Data from third party sources may have been used in the preparation of this material and Eastspring Investments has not independently verified, validated or audited such data. Where lawfully permitted, Eastspring Investments does not warrant its completeness or accuracy and is not responsible for error of facts or opinion nor shall be liable for damages arising out of any person's reliance upon this information. Any opinion or estimate contained in this document may subject to change without notice.

Eastspring Investments (excluding JV companies) companies are ultimately wholly-owned/indirect subsidiaries/associate of Prudential plc of the United Kingdom. Eastspring Investments companies (including JV's) and Prudential plc are not affiliated in any manner with Prudential Financial, Inc., a company whose principal place of business is in the United States of America.



A member of Prudential plc (UK) 