Mitch on the Markets

Is There a Tipping Point to This Trade War?

By Mitch Zacks
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The trade dispute between the U.S. and China grew last week, as the Trump administration enacted 10% tariffs on $200 billion of Chinese imports and China retaliated immediately with 10% tariffs on $60 billion of U.S. goods. For those keeping score out there, the U.S. has now levied tariffs on over $250 billion worth of Chinese goods, with China taxing just about every U.S. import possible.[1]

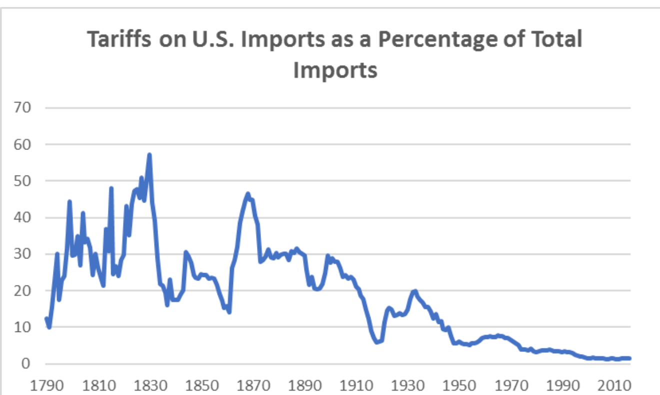
As the stakes grow higher, many investors should rightfully wonder: *where's the tipping point in this trade war? At what point are the effects of these tariffs recessionary?*

Good question! The short answer in my view is "far off," and here's why. Let's start with the silver lining of this latest round of tariffs, which is that they were initially set out to be in the 20%-25% range, but were ultimately scaled back considerably to 10% (at least for now).[2] In such a scenario, in my view, we'll see corporations absorb some of the additional cost and consumers absorb some of it too. Spread around, I don't think the impact should fundamentally alter decision-making on the consumer or corporate level.

Economic data is also indicating, at least for now, that the tariffs to date have not derailed growth patterns in either country. In the U.S., we're actually seeing some modest upticks in factory output and manufacturing according to the Chicago Fed Index,[3] and July consumer spending data (+0.3%) remains firmly in an uptrend and consistent with previous months.[4] If the trade war is supposed to be derailing U.S. economic growth, it appears that it hasn't started yet.

The same applies to China, at least to a degree. August data showed fairly robust activity in-line with previous months, with the exception of fixed-asset investment. In August, value-added industrial input was up 6.1%, retail sales jumped 9.0%, and the unemployment rate held around 5%. Fixed asset investment was a spot of concern, but the reality is that it still rose 5.3% – hardly the stuff of a recession.[5]

But, perhaps the most compelling argument for the trade war not reaching a tipping point (yet) is garnered through a macro understanding of how much these new tariffs actually represent as a percentage of total U.S. imports. Though recent moves by the Trump administration are moving the U.S. away from freer trade, it should be noted that over the last two centuries, the United States has made enormous strides towards eliminating tariffs altogether. The chart below demonstrates that tariffs used to be a much bigger factor in the economic picture than they are today. At the end of the day, even the recent uptick in tariffs has done very little to increase the overall rate:



Source: US International Trade Commission[6]

Finally, I think it's important to remember that the threat and implementation of tariffs are no longer taking the market by surprise. The most recent round of 10% on $200 billion of Chinese goods were actually first mentioned in March, with an executive order requesting a study of Chinese trade practices in July. By August, the market was largely aware that these tariffs were coming due absent a trade deal with China,[7] which never really seemed to be on the table. Any additional tariffs would need to undergo the same process, which I think gives the market plenty of time to price-in any potential impact.

Bottom Line for Investors

In my view, in order for the trade war to create a sustained market impact, it would necessitate impacting trillions of dollars in global GDP growth. As far as I see it, we're not anywhere close to those kinds of numbers. What's more, economic growth has actually improved in some areas in spite of the tariffs, and showed signs of stabilizing in others. The data we have so far offers only a small sample size, so it merits continued observation. But so far, I'd argue that the trade war is more of a political nuisance than an economic one.

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] The New York Times, September 17, 2018, https://www.nytimes.com/2018/09/17/us/politics/trump-china-tariffs-trade.html

[2] The New York Times, September 17, 2018, https://www.nytimes.com/2018/09/17/us/politics/trump-china-tariffs-trade.html

[3] Market Watch, September 24, 2018, https://www.marketwatch.com/story/us-economy-

helped-by-factories-in-late-summer-chicago-fed-index-shows-2018-09-24

[4] BEA News, August 30, 2018, https://www.bea.gov/news/2018/personal-income-and-outlays-july-2018

[5] The Wall Street Journal, September 14, 2018, https://www.wsj.com/articles/china-economic-activity-indicators-mixed-in-august-1536892284

[6] Quartz, September 26, 2018, https://www.theatlas.com/charts/SyXJGvOtf

[7] Bloomberg, September 17, 2018, https://www.bloomberg.com/news/articles/2018-09-18/the-trade-war-is-on-timeline-of-how-we-got-here-and-what-s-next

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