



Philequity Corner (March 26, 2018)

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Trade wars

The Dow plunged a whopping 724 points last Thursday and declined another 425 points last Friday as Trump approved specific tariffs against China. Following the lead of US stocks, the Nikkei plummeted 4.5%, the Shanghai Composite dropped 3.4% and the PSE Index fell 1.9% last Friday. Many have said that Trump's latest actions against China may be construed as declaration of a trade war. This has ignited fear among investors that a back-and-forth trade war between the US and China may be forthcoming.

Forms of economic wars

There are many forms of economic wars. As armed warfare has become less frequent, we have seen countries engage in economic wars instead. Below, we enumerate the different forms of economic warfare.

1. **Economic sanctions.** In 2014, the US, EU, other countries and international organizations agreed on imposing economic sanctions on Russia following its military intervention in Ukraine.
2. **Currency wars.** In the past, China was accused of engaging in competitive devaluation through the fixing of its exchange rate in order to boost its exports (*Currency Wars*, October 11, 2010).
3. **Trade wars.** This involves the undertaking of protectionist actions and the imposition of tariffs on a country's trading partners with the intention of altering the balance of trade.

Though currency and trade wars may protect a country's economic interests, it comes at the expense of its trading partners. This is the reason why these moves are referred to as beggar-thy-neighbor policies (*Beggar Thy Neighbor*, May 20, 2013).

Beginnings of a trade war

Talks of a potential trade war started when Trump ordered the imposition of tariffs on US imports of steel and aluminum. However, after offering exemptions for Canada and Mexico while also opening the door for other countries, it became apparent that Trump's ultimate target is China.

Real target is China

Trump decided last week to levy steep tariffs on imports from China as compensation for the latter's alleged violations on intellectual property. Moreover, according to Trump, the tariffs will cut the substantial trade deficit of the US with China. Trump's penchant for singling-out China is reinforced by his recent Cabinet appointments. Newly-appointed officials such as Chief Economic Adviser Larry Kudlow and State Secretary Mike Pompeo share a critical stance against China. This may further strengthen anti-China sentiment in the White House espoused by earlier appointees such as Commerce Secretary Wilbur Ross and economic adviser Pete Navarro. Thus, Trump's key advisers may end up encouraging him to implement more protectionist policies specifically targeted against China.

Trade war: US vs. China

Many investors and analysts are concerned that a potential trade war may erupt between the US and China, the two biggest economies in the world. Despite its readiness to retaliate against Trump's

protectionist policies, China stated that a trade war will not be beneficial for anyone. In fact, many economists have said that the US stands to lose more in a trade war with China.

China's 'justified and necessary response'

China stressed that it stands ready to face the consequences of Trump's actions and implement a 'justified and necessary response' to his tariffs. Last Friday, China announced plans for initial retaliatory tariffs on US imports ranging from pork, wine, steel and fruits. Moreover, China's commerce ministry proposed to impose tariffs on 128 US products as retaliation to Trump's tariffs on Chinese products.

Tit-for-tat?

Trump's enactment of protectionist policies, combined with retaliatory moves by affected countries, may result in an escalation of tensions between the US and its trading partners. Many fear that a tit-for-tat between the US and its trading partners may result in a full-blown trade war. Thus, it bears watching whether Trump is merely saber-rattling or is dead serious about sparking a global trade war.

Fear of the unknown

At this juncture, more questions have surfaced while the answers are still unknown. How will the US implement \$60b worth of tariffs against China? What sectors will be affected by these tariffs? What will the US do about China's supposed infractions on intellectual property? Will the US carry out investment and visa restrictions on Chinese citizens? What kind of retaliation will China undertake and how far will it go? Will Trump's tariffs and retaliation by China and other countries lead to a full-blown trade war? In any case, the main risk is a global trade war which will undo the progress of multi-lateral trade agreements and organizations. A trade war can stifle international trade and may undermine the ongoing global economic recovery.

Uncertainty causes volatility

Fear of the unknown has resulted in heavy selling among fund managers and investors. Rising uncertainty has caused increased volatility in the stock market as investors prefer to sell and stay in the sidelines whenever the outlook is clouded by risks. We thus believe that volatility may persist if the ongoing uncertainty remains or if the backdrop for global trade deteriorates due to a trade war.

Exercise prudence in times of volatility

At times of heightened uncertainty and volatility, we advise investors to exercise prudence and caution in their investment decisions. In times like this, it pays to review one's asset allocation strategy, risk tolerance and time horizon. Doing this will allow investors to remain calm and not be shaken by extreme volatility. Moreover, investing within a person's comfort level and tolerance limit will enable one to sleep well at night even as the stock market enters a volatile phase.

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