

Shout loudly and wave a big stick!

President Theodore Roosevelt once said, in relation to US foreign diplomacy, "Speak softly and carry a big stick." It seems President Trump has re-tasked that phrase to read, "Shout loudly (over twitter) and wave a big stick as often as possible."

The definition of a "Pyrrhic victory" is essentially where the pursuit of victory inflicts such a devastating toll on the victor, that it eliminates any benefit of being the victor. In modern history the phrase is usually reserved for nuclear war, wherein the last nation standing would be the victor, but standing in a radioactive wasteland, which negates the victory.

A few weeks ago, TAM put out musings on the potential for a trade war between China and the US, and true to form, as the world takes a distressing step closer to a full-blown trade war, market volatility has spiked to match the angst amongst investors.

Whilst a trade war is not even on the same page as a full-blown nuclear war, it does beg the question; with synchronised global growth hanging by a thread, political volatility still rife and a stock market at

record highs yet inflicted with a serious case of the jitters, is sparking a trade war between the two largest global economies really the most responsible action to be taking, considering we are potentially two years from another global recession?

Let's look at Trump's motive. First off, the apparent theft of US intellectual property by Chinese corporates appears to be a very real concern in Washington and addressing that issue seems to be garnering universal support from both sides of congress. Secondly, the state of the US China trade deficit which sits at around $375 billion in 2018 is something Trump promised to address on the campaign trail. Trump's game plan is to shut off Chinese imports, close the trade deficit and let US domestic businesses occupy the supply gap created. Trump then hits the campaign trail for his second term, being able to show a meaningful reduction in the trade deficit which, given the still potent populist movement in the US, could be what keeps him in the running for a second term.

Behind the immediate campaign promises and re-election strategy, there is a longer-term view being acted out by the US. With China's population 4.3 times the size of the US and GDP consistently growing at 6% compared to 2.2% for the US, for the Americans, it must be like watching a freight train barrelling down on you in the rear-view mirror. The US is taking prudent steps to raise the drawbridges on Chinese influence in the US, especially when it comes to the acquisition of US intellectual property and hardware, of which the US is still the world leader. No wonder then that Trump's drive for trade barriers is garnering so much support in government.

Likewise, the Chinese undoubtedly know what they are doing, and they know what's at stake. This indicates the Peoples Bank of China will use any and all methods at their disposal to shift the balance of trade power in their favour. First and foremost, this appears to be the deliberate devaluation of the Yuan against the dollar in an attempt to artificially supercharge their current export market. With the projected 0.2% decrease in Chinese GDP from the US trade war, we can also expect to see the People's Bank of China offset this with a little more domestic stimulus to "fill in the cracks" left from the decreased export market. So, don't expect to see any real slowdown to headline Chinese growth from the proposed trade tariffs.

Back to the US, and there are several channels through which Trump's pursuit of the "America first" ideology could in fact cause more harm than good. Walmart, which remains a stalwart supplier of the US household, imports over $49 billion of Chinese goods each year. Chinese imported goods with a 10-15% import levy will still be imported, with Walmart then passing this cost onto the end consumer. Alternatively, Walmart opt for a domestic alternative which will be predictably more expensive, in which case you still see this additional cost hitting the shelf price.

Either way, Trump's voter base, who largely get their weekly supplies from big US supermarkets are potentially going to see parts of their weekly shop going up by 15%, which most definitely was not in his campaign manifesto. In autos, Daimler, who own Mercedes, has announced profit warnings because of the China tariffs. It is worth mentioning that Daimler is a European company employing over 34,000 people in the US… no guesses where Daimler might make production cuts in response. Again, the loss of US jobs was not something in Trump's campaign pledge.

On the corporate front, there is a concern among domestic business owners that slapping a 15% import duty on foreign goods will actually hurt domestic production. In today's world of global supply chains, almost every single small and medium sized business in the US will have an element of its supply chain imbedded in the global import market, and could end up having to pay more to manufacture their goods, which will, in turn, drive the end price up. This could lead to the US consumer having to pay more for everything, imported or otherwise. Given the market's jitters around US inflation and its link to US interest rates, there is a chance this could add to global inflation concerns in the medium-term.

So, with all the work that Trump has done on his tax reform agenda with the potential GDP boost this brings to the US, he seems to be offsetting it by tearing up his international trade relationships in pursuit of his "America first" strategy. One cannot argue that he isn't delivering on his campaign promises with fervour, but throwing both corporate America and the American consumer under the proverbial bus could end up causing more damage to the domestic picture than he originally envisaged. So, coming back to the concept of a Pyrrhic victory, what damage does the US have to inflict on itself and its trading partners to reset the playing field with China?

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