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CNY/CNH – Tit-for-tat tariffs + relief measures = prolong uncertainties + a weaker yuan?

10 September 2018

Key Points:

- **US President Trump did not implement the tariff on USD200bn worth of Chinese imports last week, but repeated his pledge to go all in against China "*at short-notice*" last Friday**
- **On the same day, China's MOF announced measures to support some exporters with export rebate rates increasing to 9% to 17% for 397 goods**
- **China's trade figures looked all good in August, thanks to front-loaded orders ahead of the possibility of further tariffs**
- **Yet, such momentum is unlikely to be sustainable**
- **Perhaps, leaders of US and China will talk again on 18 September**
- **A softer approach would be for US to adopt a wait-and-see mode before the next talk**
- **Hardliners within the Trump's administration could nevertheless take a tougher approach**
- **Hence, the likelihood for US to impose a break to the trade war is decreasing, with trade talks possibly ending in a stalemate**
- **After all, China has too much on her plate, probably focusing more on addressing domestic issues**
- **RMB might simply follow a broad-based non-USD currency movement to depreciate, despite the recent reintroduction of some counter-cyclical measures**

US and China: Tit-for-tat tariffs far from being resolved

Despite US plan to impose tariff on USD200bn worth of Chinese imports being put on hold for now, US President Trump repeated its pledge to go all in against China, i.e., to tax all imports from China, and more importantly "*at short-notice*"

In the weekly briefing of China's Ministry of Commerce (MOFOM) on 6 September 2018 which is the deadline of the US public consultation of the tariff on USD200bn worth of Chinese imports, MOFCOM reiterated that China is forced to retaliate if US imposes additional tariffs, while **China and US has maintained contact on the working level**.

Eventually, US President Trump did not implement the tariff on USD200bn worth of Chinese imports last week, and China also did not implement the counter-measures. Yet, markets did not have much time to react to the better than expected US non-farm payroll for August with over 200k job gains and faster than expected wage growth of 0.4%SAMM, as last Friday (7 September 2018) President Trump repeated his pledge to go all in against China, i.e., to impose tariffs on the remaining USD 267bn worth of Chinese exports that would cover every product coming into US from China. He also said he is ready to tax all imports "*at short-notice*", according to Bloomberg[1].

When will leaders of US and China talk again? Perhaps, 18 September 2018

From now to 18 September, US could put the brakes on any further escalation

Perhaps, leaders of US and China will talk again at the General Assembly of United Nations in New York on 18 September. From now to then, **US could take a softer approach, i.e., to adopt a wait-and-see mode to put the brakes on any further escalation**.

[1] *Trump Threatens Tariffs on Another $267 Billion of Chinese Imports*, 8 September 2018, Bloomberg

The brake might be temporary

However, hardliners within the Trump's administration could eventually take a tougher approach. In other words, **the likelihood for US to impose tariff on USD200bn worth of Chinese imports is hence increasing, but on a positive note, there might be some room on the rate of the tariffs, which could more likely be a two-tier tariff, more on industrial goods, and less on consumer goods**, instead of a one-tier 25% tariff, as taking out of the consideration of the tariffs, consumer-price inflation in the US has already been expected to exceed the Fed's 2% target this year and next year. Against the backdrop of tight labour market conditions and quickening consumer-price inflation in US, our baseline scenario for the Fed's rate normalization remains the same as in our *MUFG Foreign Exchange Outlook, September 2018*, i.e., two more rate hikes this year, each of 25 basis points.

In short, tit-for-tat tariffs between US and China (Table 1) are far from being resolved, given the lack of talk, as we highlighted earlier in *Asia Cross Current: CNY/CNH – At the intersection point* (16 August 2018). **The chance for China to make a concession that US would be happy with appears to be low, thereby entering into a stalemate**.

TABLE 1: US AND CHINA'S TIT-FOR-TAT TARIFFS: SUMMARY

Effective date	US	China
US: 23 March 2018 China: 2 April 2018	Under Section 232, US imposed tariffs on imports of certain steel and aluminum products at 25% and 10%, respectively	China imposed reciprocal tariffs on USD 3 billion of imports from US including the first batch of USD 1 billion, including fruits, ginseng and wine etc., and the second batch of USD 2 billion, including pork, recycled steel, etc, at 15% and 25%, respectively
US & China: 6 July 2018	Under Section 301, US imposed the first round of 25% tariffs on USD 34 billion worth of imports from China, including plastics and other intermediate goods used in manufacturing	China imposed reciprocal 25% tariffs on USD 34 billion of imports from US, including soy beans, agricultural products, cars, and aquatic products etc.
US & China: 23 August 2018	Under Section 301, US imposed the second round of 25% tariffs on USD 16 billion worth of imports from China, targeting "Made in China 2025", i.e., mostly industrial goods such as tractors, plastic tubes, and measurement equipment like speedometers	China imposed 25% tariffs on an additional USD16 billion worth of imports from US, including petroleum products, plus items like coal, medical instruments, waste products, cars and buses
"*At short notice*"	US plan to impose an additional 10 % (which could be 25%) ad valorem tax on a list of at USD 200 billion worth of Chinese products	China plan to levy duties at 5% to 25% (which the effective tariff rate is about 13%) on about USD 60 billion worth of US imports, as counter measures
"*At short notice*"	US President Trump said he is ready to apply levies on the remaining USD267bn of Chinese imports which cover every product coming into US from China	

Source: MOFCOM, USTR, Bloomberg, Xinhua, MUFG Bank

China's trade figures looked all good in August, thanks to front-loaded orders

As highlighted in *Asia Cross Current: CNY/CNH – At the intersection point* (16 August 2018), China's near term strong trade momentum stayed robust (Chart 1), thanks to front-loaded orders ahead of the possibility of further tariffs.

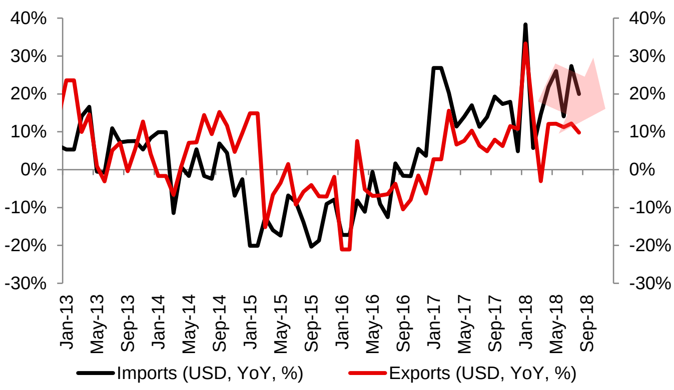
The so far robust trade activity will likely lose momentum

However, Taiwan's disappointing trade figures for August (1.9%YoY < consensus 5.1% < last 4.7%) came along with the downbeat forecast range of 0% to -3%YoY for September made by Taiwan's Ministry of Economic Affairs. The export orders gauge of China's NBS manufacturing PMI has also been on the downtrend, staying below 50 (indicating a contraction) for the third month in a row in August. All this confirms our view that the so far still robust regional trade activities will likely lose momentum in the near future, as **higher base effect will probably start to kick in, together with more cautious capex investment sentiments amid the ongoing China-US trade spat**.

Small overall merchandise trade surplus

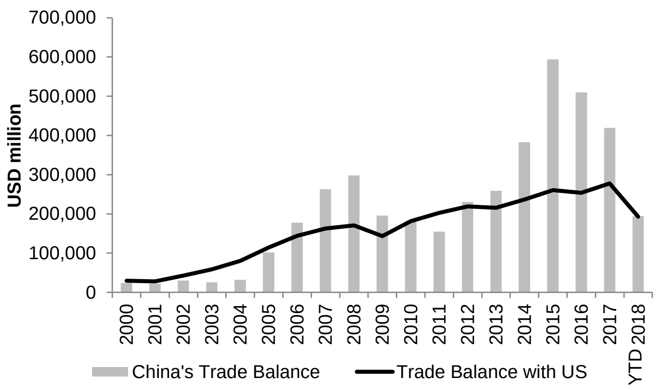
In [Asia Cross Current: USD/Asia – Some Unpleasant Macroeconomics for Trump Trade Policy] (27 June 2018), we make an outrageous claim: ***"No matter what Trump does or will do in his Trade War, it will not affect the US trade deficit"***. It is too early to conclude that our claim is correct or not, especially when the impact of the tariffs will probably be more visible next year. It is worth noting that China's overall merchandise trade surplus was close to that with the US in the first eight months of 2018 (Chart 2). So, **if China's trade balance with the US was excluded, China would be running a modest trade surplus of less than US1bn**.

CHART 1: SO FAR ROBUST MERCHANDISE TRADE ACTIVITIES WILL LIKELY LOSE MOMENTUM



Source: CEIC, MUFG Bank

CHART 2: CHINA'S OVERALL TRADE SURPLUS ≈ CHINA'S TRADE BALANCE WITH US IN 2018 YTD



Source: CEIC, MUFG Bank

China has too much on her plate

As external demand was a drag on China's economic growth in the first half of the year (Chart 3) and would probably be clouded by ongoing trade conflicts with the US which might enter into (or has already been in) a stalemate, **China would probably continue to focus on bolstering the somewhat softening domestic demand amid reappearing credit issues and modestly cooling property market** (as discussed in our previous report), **and unclogging credit supply to small and micro-enterprises amid the ongoing deleveraging**.

Last Wednesday (5 September 2019), the People's Bank of China (PBOC) Governor Yi, said monetary, fiscal and supervisory policies should be coordinated to raise the willingness of financial institutions to support small and micro-enterprises[2].

China's proactive fiscal policy: relief measures to some exporters

China's MOF announced to raise export tax rebates for some products, as part of the new fiscal measures announced by State Council in late August

Last Friday (7 September 2018), China's Ministry of Finance (MOF) announced that export rebate rates will be increased to 9% to 17% for 397 goods, such as mechanical and electrical goods, as well as cultural products, effective from 15 September 2018, according to its notice dated 5 September 2018[3].

Details of the export rebate rates are summarized below:

- *Tax rebate rates for multicomponent integrated circuits, non-electromagnetic interference filters, books, and newspapers will be increased to 16%*
- *For bamboo carving products and wooden fans, the tax rebate rates will be hiked to 13%*

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[2] China to improve financial support for small firms, *搭建对接合作平台 促进银企面对面沟通* (simplified Chinese), 5 September 2018

[3] China to raise export tax rebates for electromechanical, cultural products, 关于提高机电 文化等产品出口退税率的通知 (simplified Chinese), dated 5 September 2018

- *The tax rebate rates for basalt fiber products and safety pins will be lifted to 9%*

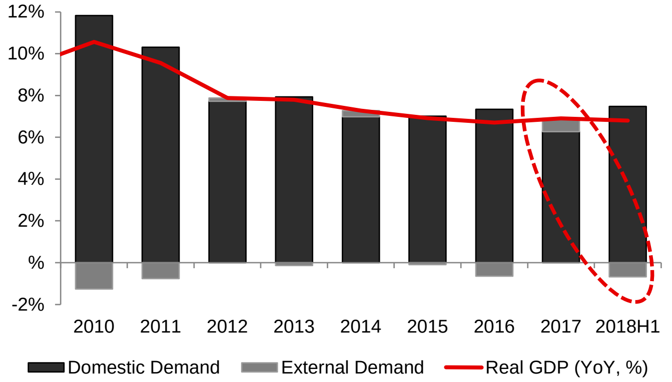
Source: China to raise export tax rebates for electromechanical, cultural products, Xinhua, 7 September 2018

The latest measure to raise export tax rebates for some products is not only a follow up action to the statement released by China's State Council on 30 August 2018 , which some export rebate rates would be increased (*完善提高部分产品出口退税率*), serving for a slightly more proactive fiscal policy, but also part of the reform of the fiscal and taxation system.

Our expectation for RMB depreciation remains intact

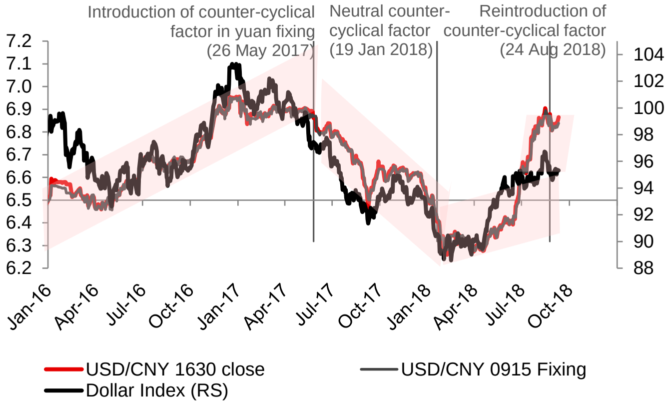
After all, China has too much on her plate, probably focusing more on addressing domestic issues, with the use of slightly more proactive fiscal policy. **The renminbi might simply follow a broad-based non-USD currency movement to depreciate, despite the recent reintroduction of some counter-cyclical measures** (Chart 4).

CHART 3: EXTERNAL DEMAND DRAGGED CHINA'S ECONOMIOC GROWTH IN THE FIRST HALF



Source: CEIC, MUFG Bank

CHART 4: PBOC'S FX MEASURES VS USD/CNY



Source: Bloomberg, PBOC, MUFG Bank

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