

Trump and his Trade Wars: A Truce not a Deal



By Jean-Philippe Bry, July 27, 2018

The Trump administration has backed off from further tariffs against Europe and other allies for now. This is a market positive, particularly for those most affected by trade. The auto sector is particularly vulnerable to tariffs on cars and auto parts given the global supply chain and the fact that Germany sells many cars to the U.S.

Arguably, Trump only responds to force and tends to reverse course if it's likely to damage him politically. It appears Trump is listening to his Republican colleagues in Congress up for re-election in the mid-west who have been increasingly concerned about the escalating trade war and the negative impact it would have on their constituencies. With the House up for grabs in the midterm elections, Trump has decided to take some heat off the trade war for now. The U.S. president's recent announcement of \$12 billion in aid for farmers in response to the retaliatory tariffs on soy beans and agricultural products is motivated by the same concerns.

This simply means that there is a truce of sorts and not a "deal" as the president of the European Commission, Jean-Claude Juncker, wrongly declared on July 25 with Trump. In fact, Trump can be viewed as a winner here since Europe has pledged to look at importing more soybeans and vastly more U.S. energy in the form of liquefied natural gas. Finally, both sides are looking to eliminate all tariffs. In reality, Europe has on average lower tariffs than the U.S., but in specific areas like autos and agriculture it's a different matter.

Europe can probably afford to eliminate auto tariffs as this was going to happen anyway in a few years, subsequent to the free trade agreement that was recently signed with Japan. However, agriculture is a different matter, particularly for France, whose farmers can be highly disruptive when they feel their livelihoods are threatened. As for energy, Europe's consumption is declining while it is oversupplied by Russia. So the agreement generally sounds positive but may be much more difficult to execute.

Importantly, the agreement stipulates that no additional tariffs will be imposed while the parties are talking – a move that alleviates tensions and the disruptive threat of auto and auto-part import tariffs. However, tariffs on steel and aluminum continue to stand and the U.S. Commerce Department is still investigating the dubious threat of auto imports on national security. The upshot? The threat of tariffs over the long term has not been eliminated.

Generally, this is a positive for North American Free Trade Agreement (NAFTA) talks, which are likely to resume in the next few weeks. Abandoning NAFTA is not politically popular in the U.S., neither within the "agriculture states," or the "auto mid-western states"; so again this tactic should

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be viewed as politically motivated to appease the electorate that progress can be made. And maybe progress will be made.

Trump is so inconsistent on trade that all of this could come undone at any point; but, given the political dynamics and the fact that Trump is listening to his Republican congressional colleagues, he's latest decisions are likely to last until the midterm elections in November. This should be a reprieve for some markets, especially those markets most affected by trade.

Finally, this is not likely to change the pressure on China as this approach remains politically popular, even if farmers are concerned. So while the Trump administration's trade dispute with allies is generally less strained, the harsh rhetoric is unlikely to subside against China, leaving a general sense of uncertainty as to how the situation will unfold over the long term.

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