Trump's Tariff Spree could end up Fast-Tracking China's rise

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Early into his second term, US President Donald Trump has lived up to his image of being a Great Disruptor with his across-the-board (country-wise and commodity-wise) increase in tariffs on imports into the US. In the process, he has launched a new episode in the much-hyped US-China economic and geopolitical standoff.

The Chinese government is the only one that stood up firmly to Trump's aggression in the form of tariff hikes, which in the case of China was initially a two-step increase totalling 54 per cent (20 per cent + 34 per cent). China responded with a matching 34 per cent tax on all imports from the US and combined it with an engineered depreciation of the Chinese RMB, targeted restrictions on sundry US companies, curbs on US access to rare earth minerals, and an investigation into the operations of the US chemicals major DuPont in China. Meanwhile, rattled by the impact of his actions on markets that tanked, Trump blinked and announced a 90-day pause on reciprocal tariffs imposed on all trading partners, leaving that at 10 per cent instead. But China has been singled out. Angered by China's strong response, Trump has raised the total tariff hike (above a prevailing 21 per cent) on imports from China to 104 per cent. As soon as Trump announced that decision, China declared that it would continue to "fight to the end".

The US-China standoff is unique. All countries were affected by Trump's tariff proposals, involving an equal 10 per cent base tariff hike and differential imposts via specific commodity taxes (automobiles and aluminium, for example) and via supposedly "reciprocal" tariffs aimed at neutralising a crudely estimated figure of a country's protection against imports from the US using tariffs, quantitative restrictions, and exchange rate manipulation to engineer a trade surplus. The imposts are hardly reciprocal. Some poor and small countries like Cambodia and Laos, only marginal players in US trade, have been slapped with the highest increases. The EU has threatened to retaliate but is holding back for now. Most others have opted for negotiations with the US administration and signalled that they are willing to offer major concessions in return for a reduction in the new tariffs.

Despite the pause, given the high share of China and the US in global trade (imports and exports), the unfolding tariff war is bound to disrupt world trade, forcing a significant reordering of flows. The question is which of them would hurt more.

The US is bound to be badly hit. Not only would exports from the US to China shrink, but also the sudden contraction of imports from China into the US would disrupt supply chains created to offshore and outsource production to cheaper, lower wage locations. That helped keep domestic inflation under control. The post-COVID inflation triggered by clogged supply chains pointed to the dangers of disrupting those chains.

The 90-day pause notwithstanding, Trump will be hard put to find alternative sources of cheap imports. Even if some countries negotiate a reduction in the Trump tariffs with major concessions on their part, the capacities they together have to immediately substitute imports from China would be inadequate. Supply constraints and price increases would be impossible to avoid. And, even if Trump's ambition to bring American manufacturing back to the country is realised, it will take time.

Disruption and inflation in the US and elsewhere are inevitable, explaining the turmoil in the markets and the growing turn against Trump by US billionaires, many of whom had previously sung his praises. Wealthy holders of financial assets are bound to be frightened by the threat of inflation that would reduce the real value of their assets. They would also fear the likely adoption of controls on cross-border flows of capital by dollar-starved recipient countries, which would shrink the space they have to extract large profits. Trump's obsession with tariffs that these wealth holders had initially ignored is turning out to be a bazooka that could obliterate the large profits they had grown accustomed to.

China too would be initially hurt. Substantially dependent on US markets, it would find its economic expansion that has already slowed weakening further. Moving capacity from China to other locations may not help much since all countries face enhanced tariffs, and the Trump administration is likely to watch closely for Chinese attempts to use alternative bases to access the US market. Some short-term pain is inevitable.

But in the medium term, the Trumpian view that short-term pain would be good for long-term performance (in the US) might actually prove true for China instead. The Chinese government, which is known to help Chinese exporters expand abroad, may offer subsidies to make Chinese goods cheaper in global markets. Efforts at an engineered depreciation of the RMB would help. China could also team up with countries seeking to counter US trade aggression by forming new trading blocs.

Finally, and perhaps most importantly, since China is a major importer from many countries outside the US, it could in multiple ways (increased imports, grants, investments, and swaps) enhance access of these countries to the RMB needed to finance imports from China and increase its footprint in their markets. With the US home to the world's dominant reserve currency unwilling to run large deficits to supply the global economy with the dollars it demands, importing countries are likely to seek alternative sources, favouring imports priced in currencies more accessible than the dollar.

There is evidence that these trends are gathering momentum. Trade cooperation discussions between the Asian majors China, Japan, and Korea have revived after a long freeze. If they do cooperate, they could keep the US out of a large chunk of the global markets for a variety of goods. More countries are signing up to use China's CIPS (Cross-Border Interbank Payments System) as an alternative to SWIFT (Society for Worldwide Interbank Financial Telecommunication) that mediates dollar-denominated transactions. That would favour trade with China. And, China is clearly willing and eager to internationalise the RMB and enhance access to it.

This would imply that the trade benefits that could accrue to China as a result of Trump's actions would also be accompanied by a growing role for and strengthening of the Chinese currency and of the Chinese presence in global markets. In short, Trump may have triggered trends that could accelerate the rebalancing of global economic power and undermine US hegemony in favour of a rising China. Despite the pause, given the high share of China and the US in global trade (imports and exports), the unfolding tariff war is bound to disrupt world trade, forcing a significant reordering of flows. The question is which of them would hurt more.

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