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Investment Event

A further escalation in trade tensions

Trade tensions escalated after China announced additional tariffs on US goods and the US retaliated with an increase in tariffs on Chinese imports

Meanwhile, Fed Chair Powell refrained from providing a clear steer on future interest rate policy, but reiterated the Fed will act as appropriate to sustain growth

Global uncertainty increases risks to growth but accommodative fiscal and monetary policies should continue to support risk assets

Our views

Our core asset class views are unchanged. We maintain a pro-risk stance in our multi-asset portfolios given a supportive global policy backdrop, despite the increased risks to growth

US-China conflict escalates

At the end of last week, US-China trade tensions escalated further, as China announced plans to impose additional tariffs on USD75bn of imports from the US, including soybeans, autos and oil. This measure was announced in retaliation for US President Trump's planned levies on Chinese imports announced earlier this month.

In response, Trump announced he would retaliate in kind, demanding US companies seek "an alternative to China". After market close on Friday, he announced the US would increase tariffs from 25% to 30% on USD250bn of Chinese imported goods already subject to tariffs since May, and from 10% to 15% on some of the USD300bn worth of goods with tariffs to be introduced on 1 September and 15 December. He also threatened to order US companies to stop doing business with China, citing the 1977 International Emergency Economic Power Act, which gives the President the power to regulate international transactions under specific circumstances.

Trump's comments came immediately after US Fed Chair Powell spoke at the annual Jackson Hole Economic Policy Symposium where he stated that fitting trade uncertainty into the Fed's policy framework was "a new challenge" and also reiterated that the Fed would "act as appropriate to sustain the expansion". While Powell didn't make reference to the "mid-cycle rate adjustment" argument used to explain the fed fund rate cut in July, he did not push back against market pricing of another rate cut in September and refrained from providing a clear steer on future interest rate policy.

The initial market reaction in Asia was negative: the Nikkei 225 lost up to 2.6% while the Shanghai Composite dropped 1.7% at opening. China's yuan depreciated 0.7% shortly after market opening, hitting close to 7.15 against the US dollar. Meanwhile, perceived safe assets benefitted, with the yen briefly falling below 104.5, gold gaining 1.9%, reaching its highest level in more than six years and US 10-year yields touching the 1.5% symbolic level for the first time since 2016. However, risk sentiment seemed to improve as equities gradually erased some of their early session losses.

Increased risk to growth

Although we believe the latest measures are unlikely to have a meaningful *direct* economic impact, the escalation is likely to weigh on already fragile investor risk appetite and general economic confidence. This presents a further challenge to the global economic backdrop which is already facing headwinds from a downturn in the industrial cycle and elevated uncertainty amid geopolitical risks.

The *indirect* impact of the trade tensions on sentiment and investment decisions could be more meaningful. Using the Oxford Economics global macroeconomic model, we estimate the impact of a full implementation of the US and Chinese tariffs and a significant decline in global confidence. The impact on global growth is marginal (-0.1 percentage point) in 2019 and more important in 2020 (slightly below 1ppt), with a roughly equal impact in China and the US.

However, we still believe the global economy can withstand the latest escalation. Despite pockets of weakness in Europe and China, US growth remains robust, with a strong US consumer sector – confidence is above average levels, unemployment is low and the saving ratio is at healthy levels – which should allow it to absorb moderately higher prices on goods affected by the tariffs. Crucially, global policymakers have ammunition to offset the economic hit, both via monetary policy loosening, but also via fiscal easing measures. Most central banks have pivoted to a pro-growth stance since the beginning of the year, especially in the US and the Eurozone. Meanwhile, Chinese authorities are actively implementing fiscal policy support as well as advancing key reforms like the reform of the benchmark lending rate setting mechanism, announced on Friday 16 August, designed to improve the transmission mechanisms of monetary policy.

Market considerations

With the valuation gap between equities and relatively expensive bonds continuing to increase, we remain comfortable with our pro-risk stance in multi-asset portfolios. On a tactical basis, however, we continue to advocate a more cautious use of our risk budget in portfolios.

Furthermore, for EM assets, we have a tactical preference for local-currency government bonds over EM equities, with the latter more exposed to signs of weaker company earnings performance amid global trade tensions. Local-currency government bonds would also benefit from EM central banks loosening policy in the face of growth headwinds.

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