

Trade Wars and the Land of the Rising Sun

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Like the very cute child who put her hand to the TV set in Steven Spielberg's classic ghost story, *Poltergeist*: They're here. . . "They" are the trade wars that we have all been reading about in the financial press. The trade wars began with the United States and China but have now expanded to Japan as well.

Let's recap for a moment. Putting politics aside, it is important to remember that President Trump campaigned on an "America First" platform. He made clear his intentions long before he ever took the Oath of Office or entered the Oval Office. But Trump is not alone in his protectionist stance. Brexit was a clear demonstration of "U.K. First" — the protection of U.K. jobs by withdrawing from the European Union. And Russia is pursuing a Russia First /Putin First trade policy — it is very hard to separate the identity of Putin from Russia.

Importantly, this leaves the door wide open for China to assume a larger role in setting global economic policy. With Russia, the U.S., and the U.K. all looking inwardly, [emerging market](#) nations need another superpower to turn to for foreign direct investment, infrastructure, and other economic support. I will come back to China in a moment.

I recently returned from a trip to Japan, and the nation's mood towards President Trump's trade policies is definitely somber. While I was in Japan, President Trump met with Prime Minister Shinzo Abe back in the United States. Having dined with the Prime Minister, President Trump released a tweet after the meal indicating that he intended to maintain the U.S.'s withdrawal from the Trans-Pacific Partnership Agreement. This is the trade agreement that allows the free flow of goods back and forth between the U.S. and Japan without any restrictions, tariffs, or other economic barriers. President Trump's tweet was a blow to Japanese exports to the United States.

Potentially, President Trump may sense a weakness in the current Abe cabinet. Unfortunately for the Japanese Prime Minister, his administration is mired in several scandals; two of which unfolded while I was in Japan. First, Abe's powerful finance minister, Junichi Fukuda resigned his office over allegations of sexual harassment. Vice Minister Fukuda was caught on tape making inappropriate comments to a female reporter and those comments were subsequently posted on the internet. A second scandal erupted relating to Mr. Abe's wife with respect to the purchase of government land at deeply discounted prices. In this latter case, government officials falsified documents in a clumsy and illegal attempt to protect the Prime Minister and his wife. As a result, Prime Minister Abe's public rating has plunged to its lowest level of 31 percent, raising the very real possibility that Mr. Abe will not survive the September elections in Japan.

With the state of Japan's political travails in mind, President Trump has all of the advantage on his side to apply trade restrictions that attempt to protect the U.S., to the detriment of Japan. But there will be repercussions. This takes us back to China.

China's top diplomat, Wang Yi, met with Prime Minister Abe last week to engage in the first China/Japan economic policy summit in a decade. Importantly, this summit focused on trade wars and the two nations issued a joint statement that "any trade war poses a threat to global growth and the two nations will increase their efforts to cooperate." Without naming the United States, this statement was squarely directed at President Trump's tariff war. Furthermore, the two nations stated that Japan would be a valued partner in China's "One Belt, One Road" infrastructure network in Asia, the Mideast, and Africa. Importantly, both Japan and China have been caught up in the steel and aluminum tariffs implemented by the Trump Administration in March. And, Japan is the only major ally of the United States that has not been granted an exemption from U.S. steel and aluminum tariffs — which were meant to be directed at China.

Yet, for all of the sabre rattling over tariffs, the impact to economic activity is small. The table below shows the impact on the tariffs with respect to global trade. We can observe that for the U.S., China and Japan, the reduction in GDP is small.

A SERIOUS TRADE WAR WOULD PUT GLOBAL GROWTH AT RISK, BUT THE TARIFFS ANNOUNCED THUS FAR IMPLY A VERY SMALL ECONOMIC IMPACT

Numbers in percent	Impact of Announced Tariffs on		
	United States GDP	China GDP	Japan GDP
Goods Imports % of GDP	12	15	14
Share of Goods Imports	China: 22	United States: 8	United States: 11
GDP Impact (bps)	10 bps	10 bps	< 10 bps

Source: Cornerstone Macro, Commonfund

In times of war, blockades are what enemy nations impose upon each other to restrict the flow of goods. And, in times of peace, tariffs accomplish the same objective — but are self-inflicted. Nonetheless, we see only a small impact on GDP growth in the U.S., China, and Japan. In fact, the International Monetary Fund (IMF) last week re-affirmed its 2018 forecast for global GDP growth at 3.9 percent. Consequently, while we continue to monitor these protectionist policies — and the potential to ratchet up the rhetoric — we are sticking with the game plan — maintaining our preference for an overweight to equities with a bias to move toward neutral over time.

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