

CIO Viewpoint

The unexpected and predictable consequences of trade wars

Investment Solutions

11 June 2019

The Trump administration clearly sees the current strength of the US economy as a window of opportunity to counter China's rise as a superpower. Whatever the short-term cost to the US economy. In order to counter China's economic rise, the present US administration has weaponised trade with the goal of shutting out China's supply chain, even if that leaves the American economy and markets reeling to adjust.

When China joined the World Trade Organisation in 2001, the US and Europe expected reforms to create an increasingly western liberal economy. As we mark the 30th anniversary of the Tiananmen Square massacre, the US tariffs show that the relationship has significantly changed in recent years.

There is no sign that China and the US are any closer to finding common ground in their disputes. On the contrary, the rhetoric has worsened with the US ban on its technology firms from doing business with China's telecommunications company, Huawei, over security concerns. Formally, the next meetings will be at the G20 Summit scheduled for 28-29 June in Japan, where we don't expect a breakthrough. In the meantime, China's President Xi Jinping is signing new agreements in Moscow with his "[best and bosom friend](#)" Russian President Vladimir Putin.

Short-term winners, more targets

The [US tariffs on China](#) are already disrupting trade flows globally as suppliers and importers find routes around the mutually-imposed tariffs. US imports from Vietnam, South Korea and Taiwan have increased over the past six months while China has increased its exports to those three countries (see chart 1).

In the circumstances, we are watching carefully other trade threats from Trump who has made reducing the US's trade deficit into a cornerstone of his presidency (see chart 2). [The International Monetary Fund](#) has argued that the US/China tariffs will cost USD 455 billion in lost production next year. Tariffs look like the wrong weapon for the wrong target.

In March the US administration announced that it no longer considers Turkey and India as developing countries, which means their exporters will lose their exemptions from US tariffs. [The decision](#), in effect this month, says that Turkey "is sufficiently economically developed" and India has failed to promise that it will give US exporters "equitable and reasonable access to its markets." The US is India's biggest trade partner, accounting for one-sixth of exports by value. The US has also investigated the weakness of the Singaporean and Malaysian currencies.



Stéphane Monier
Chief Investment Officer, Lombard Odier Private Bank

Key takeaways

- Despite the impact on the US economy, the Trump administration looks determined to undermine China's supply chain and rise as a superpower
- The two sides look no closer to a deal and shipments are already finding new routes around the US tariffs via Vietnam, South Korea and Taiwan
- The US has removed preferential tariff treatment from India and Turkey and it is poised to impose tariffs on EU imports over aircraft subsidies
- The US used the tariff threat to reach a bilateral migration deal with Mexico
- Trade remains the most important threat to the global economy.

Important information: Please read the important information at the end of the document.

Weekly publication of Lombard Odier - Contacts: Investment Solutions, investment-solutions@lombardodier.com

Data as of 11 June 2019 unless otherwise stated.

Lombard Odier · CIO Viewpoint · 11 June 2019

Trump is also targeting the [European Union's trade surplus with the US](#), affecting German carmakers with a list of imported parts worth USD 53 billion that may be subject to tariffs unless talks can make progress. In July, the WTO will rule whether the US can go ahead with USD 21 billion of tariffs on EU goods related to a dispute over subsidies to Airbus (a similar WTO case may rule against Boeing in 2020).

'Tariff Man' pauses

President Trump is increasingly relying on tariffs as a negotiating weapon in its international relations. The US had threatened in May to start a new front in its trade war by applying a 5% tariff on all Mexican imports, with a 5% rate raised in increments at the beginning of each month to a 25% tariff in October. President Trump linked the tariffs with what he had described as "the illegal inflow of aliens" from Mexico.

An agreement reached 7 June between the US and Mexico "consists largely of actions that Mexico had already promised to take in prior discussions with the United States over the past several months," including deploying the Mexican National Guard and detaining asylum seekers in Mexico while their cases are considered, according to the New York Times. Whether Mr Trump has presented the agreement over border measures following pressure from within his own Republican party, or simply understood the damage they would do, on 10 June he then tweeted that unless the Mexican government implements the agreement, the threatened tariffs would still go ahead.

The danger is that the Trump administration "is trying to use tariffs to solve every problem but HIV and climate change," Republican Senator James Lankford [said last week](#).

Mexico relies on the US market for nearly 30% of its Gross Domestic Product, so any new tariffs on its exports would erode profit margins and undermine jobs.

'Massive return of jobs'

From the US's economic point of view, it may look an odd time to start additional trade disputes. The logic in the Mexico case, according to the [White House statement](#), was that high tariffs on Mexican goods mean "companies located in Mexico may start moving back to the United States" leading to "a massive return of jobs back to American cities and towns."

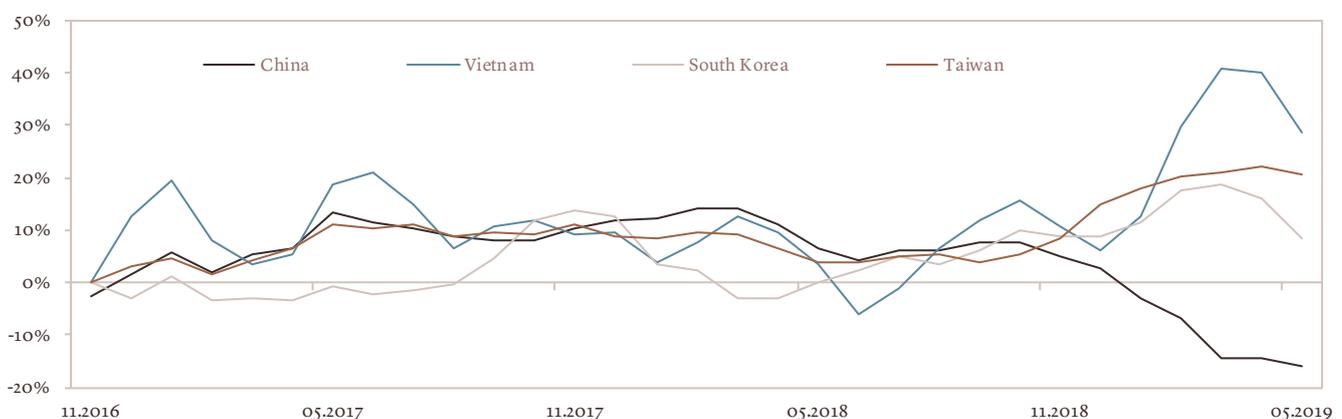
If the US hopes to boost domestic manufacturing, it seems unlikely that jobs would necessarily move to the US where the labour shortages may rather raise wages. At 3.6%, unemployment in the US is at its lowest level in 50 years and the sectors most likely affected by any tariffs would suffer the most from any labour shortages. First hit on the target list would be transportation equipment (mostly car parts), which make up more than one-third of Mexico's exports to the US worth USD 120 billion in 2018, and is the sector which registered the widest trade deficit with Mexico last year.

The tariffs on China are already forecast to increase US inflation as the higher costs of imports hit household spending and businesses' supply chains. That has knock-on implications for US GDP, which would be compounded by any weakening in equity markets.

The threat of Mexican tariffs also surprised since on 17 May the US agreed with Canada and Mexico to lift tariffs on imports of steel and aluminium and drop their related disputes at the World Trade Organisation. The duties were blamed for stalling the ratification of the United States-Mexico-Canada Agreement (USMCA), signed last November.

Under the still-in-effect NAFTA (North American Free Trade Agreement) between Mexico, Canada and the US, most trade between the three economies is duty-free while globally the US's average tariff was 1.7% in 2017, according to the [World Bank](#).

Chart 1 - Trading substitutes: rise in US imports from Vietnam, South Korea and Taiwan
% change, yoy



Sources: Bloomberg, US Census Bureau

Negotiating credibility

Mexico is the largest supplier to the US in vehicle and car parts and machinery, making it difficult for US manufacturers to find alternative suppliers for parts that in the course of their production cross the border multiple times (and so paying a tariff each time).

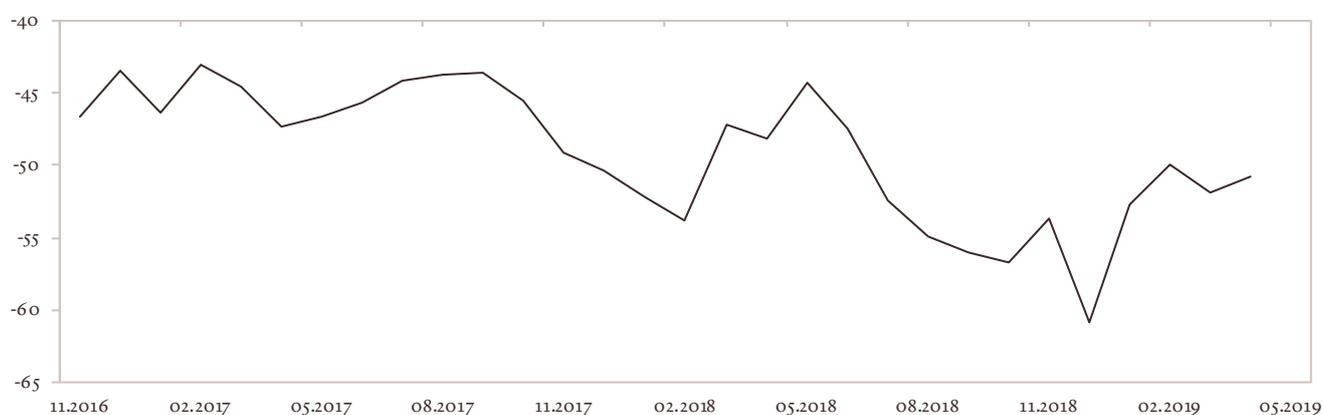
In addition, unlike Chinese exporters to the US, manufacturers shipping auto parts across the US/Mexican border have fewer options to re-route their business.

These fresh tariff-induced uncertainties have important short-term implications because they undermine the Trump administration's credibility in negotiations with China. The US is supposed to be close to ratifying the USMCA, but the dispute with Mexico suggest that it can't be entirely trusted to honour commitments already made with its nearest neighbours. This is damaging the US's standing as a reliable counterpart in any international negotiations, and leading to increased market volatility.

As the American political calendar moves toward 2020's presidential election, it looks likely that President Trump wants to be seen by his electorate moving from 'Tariff Man' to 'Dealmaker'. This is a dangerous approach as manufacturing and economic output is dependent on the uninterrupted trade flows established over the past few decades.

While it seems that Mr Trump may be more reluctant to treat his closest economic partners and allies in the same way as China, global trade remains highly sensitive to disruption. As we have pointed out before, it remains [the single greatest threat to the world's economic activity](#), with an impact that has surprised everyone with its speed and spread.

Chart 2 - United States trade balance (goods and services)
In USD bn



Sources: Bloomberg, US Census Bureau

Important information

This is a marketing communication issued by Bank Lombard Odier & Co Ltd (hereinafter “Lombard Odier”). It is not intended for distribution, publication, or use in any jurisdiction where such distribution, publication, or use would be unlawful, nor is it aimed at any person or entity to whom it would be unlawful to address such a marketing communication. This marketing communication is provided for information purposes only. It does not constitute an offer or a recommendation to subscribe, purchase, sell or hold any security or financial instrument. It contains the opinions of Lombard Odier, as at the date of issue. These opinions and the information contained herein do not take into account an individual’s specific circumstances, objectives, or needs. No representation is made that any investment or strategy is suitable or appropriate to individual circumstances or that any investment or strategy constitutes personalised investment advice to any investor. Each investor must make his/her own independent decisions regarding any securities or financial instruments mentioned herein. Tax treatment depends on the individual circumstances of each person and may be subject to change in the future. Lombard Odier does not provide tax advice. Therefore, you must verify the above and all other information provided in the marketing communication or otherwise review it with your external tax advisors. Some investment products and services, including custody, may be subject to legal restrictions or may not be available worldwide on an unrestricted basis. The information and analysis contained herein are based on sources considered reliable. Lombard Odier uses its best effort to ensure the timeliness, accuracy, and comprehensiveness of the information contained in this marketing communication. Nevertheless, all information and opinions as well as the prices, market valuations and calculations indicated herein may change without notice. **Investments are subject to a variety of risks.** Before entering into any transaction, an investor should consult his/her investment advisor and, where necessary, obtain independent professional advice in respect of risks, as well as any legal, regulatory, credit, tax, and accounting consequences. The investments mentioned in this marketing communication may carry risks that are difficult to quantify and integrate into an investment assessment. In general, products such as equities, bonds, securities lending, forex, or money market instruments bear risks, which are higher in the case of derivative, structured, and private equity products; these are aimed solely at investors who are able to understand their nature and characteristics and to bear their associated risks. On request, Lombard Odier will be pleased to provide investors with more detailed information concerning risks associated with given instruments. **Past performance is no guarantee of current or future returns, and the investor may receive back less than he/she invested.** The value of any investment in a currency other than the base currency of a portfolio is subject to the foreign exchange rates. Exchange rates may fluctuate and adversely affect the value of the investment when it is realised and converted back into the investor’s base currency. The liquidity of an investment is subject to supply and demand. Some products may not have a well-established secondary market or in extreme market conditions may be difficult to value, resulting in price volatility and making it difficult to obtain a price to dispose of the asset. **This marketing communication is not issued by the organisational unit of the Bank Lombard Odier & Co Ltd responsible for the production of financial research**, as defined under the Swiss Bankers Association Directives on the Independence of Financial Research. Consequently, it is not prepared in accordance with the provisions of the referred Directives or any other legal requirements designed to promote the independence of the production of financial research. Opinions expressed in this marketing communication may differ from the opinions expressed by other divisions of Lombard Odier, including Bank Lombard Odier & Co Ltd’s Research Department. Nevertheless, if opinions from financial analysts belonging to the Research Department are contained herein, such analysts attest that all of the opinions expressed accurately reflect their personal views about any given instruments. In order to ensure their independence, financial analysts are expressly prohibited from owning any securities that belong to the research universe they cover. Lombard Odier may hold positions in securities as referred to in this marketing communication for and on behalf of its clients and/or such securities may be included in the portfolios of investment funds as managed by Lombard Odier or affiliated Group companies. Lombard Odier recognises that conflicts of interest may exist as a consequence of the distribution of financial instruments or products issued and/or managed by entities belonging to the Lombard Odier Group. Lombard Odier has a Conflict of Interests policy to identify and manage such conflicts of interest. **European Union Members:** This marketing communication has been approved for use by Lombard Odier (Europe) S.A. in Luxembourg and by each of its branches operating in the following territories: **Belgium:** Lombard Odier (Europe) S.A. Luxembourg · Belgium branch; **France:** Lombard Odier (Europe) S.A. · Succursale en France; **Italy:** Lombard Odier (Europe) S.A. · Italian Branch; **Spain:** Lombard Odier (Europe) S.A. · Sucursal en España; and **United Kingdom:** Lombard Odier (Europe) S.A. · UK Branch. Lombard Odier (Europe) S.A. is a credit institution authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg. **Notice to investors in the United Kingdom:** Lombard Odier (Europe) S.A. · UK Branch is authorised in the UK by the Prudential Regulation Authority (PRA) and is subject to limited regulation by the Financial Conduct Authority (FCA) and the PRA. **Details of the extent of our authorisation and regulation by the PRA/regulation by the FCA are available from us on request. UK regulation for the protection of retail clients in the UK and the compensation available under the UK Financial Services Compensation Scheme does not apply in respect of any investment or services provided by an overseas person.** In addition, this marketing communication has also been approved for use by the following entity domiciled within the European Union: **Spain:** Lombard Odier Gestión (España) S.G.I.I.C., S.A.U., an investment management company authorised and regulated by the Comisión Nacional del Mercado de Valores (CNMV), Spain. **Panama:** This marketing communication has been approved for use in Panamá by Lombard Odier (Panamá) Inc., an entity authorised and regulated by la Superintendencia del Mercado de Valores de Panamá. Licensed to operate as an Investment Adviser. Res. SMV No.528-2013.

Israel: This marketing communication has been approved for use in Israel by the Israel Representative Office of Bank Lombard Odier & Co Ltd, an entity not supervised by the Supervisor of Banks in the Bank of Israel, but by the Swiss Financial Market Supervisory Authority, which supervises the activities of Bank Lombard Odier & Co Ltd.

South Africa: This marketing communication has been approved for use in South Africa by the South Africa Representative Office of Bank Lombard Odier & Co Ltd, an authorised financial services provider Registration number 48505.

Switzerland: This marketing communication has been approved for use in Switzerland by Bank Lombard Odier & Co Ltd Geneva, a bank and securities dealer authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).

United States: Neither this document nor any copy thereof may be sent to, taken into, or distributed in the United States of America, any of its territories or possessions or areas subject to its jurisdiction, or to or for the benefit of a United States Person. For this purpose, the term “United States Person” shall mean any citizen, national or resident of the United States of America, partnership organised or existing in any state, territory or possession of the United States of America, a corporation organised under the laws of the United States or of any state, territory or possession thereof, or any estate or trust that is subject to United States Federal income tax regardless of the source of its income. This marketing communication may not be reproduced (in whole or in part), transmitted, modified, or used for any public or commercial purpose without the prior written permission of Lombard Odier.

Media: Lombard Odier would like to offer you for your information the enclosed CIO Viewpoint. In connection with the use of the enclosed document Lombard Odier kindly draws your attention to certain particular items/conditions. The information sent is for your personal use only. In case of quoting please cite Lombard Odier in no other capacity than as source of information only. For the sake of good order Lombard Odier would like to remind you that responsibility regarding quoted content and compliance with applicable regulations rests with you. The information provided does not constitute the provision of investment advice or an offer of any financial services especially not to the public.

Data protection: You may be receiving this communication you have provided us with your contact details. If this is the case, note that we may process your personal data for direct marketing purposes. If you wish to object to this processing, please address your objection to the Group’s Data Protection Officer: Bank Lombard Odier & Co Ltd, Group Data Protection Officer, 11, Rue de la Corraterie, 1204 Geneva, Switzerland. E-Mail: group-dataprotection@lombardodier.com. For more information on Lombard Odier’s data protection policy, please refer to www.lombardodier.com/privacy-policy.

© 2019 Bank Lombard Odier & Co Ltd – all rights reserved. Ref. *LOCH/LOESA-MWNPR-en-062019*.

SWITZERLAND

GENEVA

Bank Lombard Odier & Co Ltd¹

Rue de la Corraterie 11 · 1204 Genève · Suisse
geneva@lombardodier.com

Lombard Odier Asset Management (Switzerland) SA

Avenue des Morgines 6 · 1213 Petit-Lancy · Suisse
Support-Client-LOIM@lombardodier.com
Management Company regulated by the FINMA.

FRIBOURG

Banque Lombard Odier & Cie SA · Bureau de Fribourg¹

Rue de la Banque 3 · 1700 Fribourg · Suisse
fribourg@lombardodier.com

LAUSANNE

Bank Lombard Odier & Co Ltd¹

Place St-François 11 · 1003 Lausanne · Suisse
lausanne@lombardodier.com

VEVEY

Banque Lombard Odier & Cie SA · Agence de Vevey¹

Rue Jean-Jacques Rousseau 5 · 1800 Vevey · Suisse
vevey@lombardodier.com

ZURICH

Bank Lombard Odier & Co Ltd¹

Utoschloss · Utoquai 29-31 · 8008 Zürich · Schweiz
zurich@lombardodier.com

EUROPE

BRUSSELS

Lombard Odier (Europe) S.A. Luxembourg · Belgium branch²

Avenue Louise 81 · Box 12 · 1050 Brussels · Belgium
brussels@lombardodier.com

Credit institution supervised in Belgium by the Banque nationale de Belgique (BNB) and the Financial Services and Markets Authority (FSMA).

LONDON

Lombard Odier (Europe) S.A. · UK Branch²

Queensberry House · 3 Old Burlington Street · London
W1S 3AB · United Kingdom ·
london@lombardodier.com

The Bank is authorised and regulated in the UK by the Prudential Regulation Authority (PRA) and subject to limited regulation by the Financial Conduct Authority (FCA) and the PRA. Details of the extent of our authorisation and regulation by the PRA and regulation by the FCA are available from us on request. Registered in Luxembourg No. B169 907.

Lombard Odier Asset Management (Europe) Limited

Queensberry House · 3 Old Burlington Street · London
W1S 3AB · United Kingdom ·
london@lombardodier.com

Investment firm authorised and regulated by the Financial Conduct Authority (FCA register No.515393).

LUXEMBOURG

Lombard Odier (Europe) S.A.

291, route d'Arlon · 1150 · Luxembourg · Luxembourg
luxembourg@lombardodier.com

Credit institution authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.

Lombard Odier Funds (Europe) S.A.

291, route d'Arlon · 1150 · Luxembourg · Luxembourg
luxembourg@lombardodier.com

MADRID

Lombard Odier (Europe) S.A. · Sucursal en España²

Paseo de la Castellana 66 · 4^a Pl. · 28046 Madrid · España · madrid@lombardodier.com

Credit institution supervised in Spain, by the Banco de España and the Comisión Nacional del Mercado de Valores (CNMV).

Lombard Odier Gestión (España) S.G.I.I.C, S.A.U.

Paseo de la Castellana 66, 4^a Pl. · 28046 Madrid · España · madrid@lombardodier.com

Management Company supervised by the Comisión Nacional del Mercado de Valores (CNMV).

MILAN

Lombard Odier (Europe) S.A. · Succursale in Italia²

Via Santa Margherita 6 · 20121 Milano · Italia
milano-cp@lombardodier.com

Credit institution supervised in Italy by the Commissione Nazionale per le Società e la Borsa (CONSOB) and la Banca d'Italia.

MOSCOW

Bank Lombard Odier & Co Ltd · Representative Office Moscow

Letnikovskaya st.2, bld.1 · 115114 Moscow · Russian Federation · moscow@lombardodier.com

Under the supervisory authority of the Central Bank of the Russian Federation.

PARIS

Lombard Odier (Europe) S.A. · Succursale en France²

8, rue Royale · 75008 Paris · France. RCS PARIS B 803 905 157 · paris@lombardodier.com

Credit institution supervised in France by the Autorité de contrôle prudentiel et de résolution (ACPR) and by the Autorité des Marchés Financiers (AMF) in respect of its investment services activities. Business permit No.23/12. Registered in Luxembourg - No.B169 907.

Insurance intermediary authorised by the Commissariat aux Assurances (CAA) No.2014 CM002. The registration with the CAA can be verified at www.orias.fr.

AFRICA | AMERICAS | MIDDLE EAST

ABU-DHABI

Bank Lombard Odier & Co Ltd · Abu Dhabi Global Market Branch

Al Maryah Island · Abu Dhabi Global Market Square · Al Sila Tower · Abu Dhabi · abudhabi@lombardodier.com

Arranging Deals in Investments · Advising on Investment or Credit · Arranging Credit. Regulated by the ADGM Financial Services Regulatory Authority.

BERMUDA

Lombard Odier Trust (Bermuda) Limited

3rd Floor, Victoria Place · 31 Victoria Street · Hamilton
HM 10 · Bermuda · bermuda@lombardodier.com

Licensed to conduct Trust, Investment and Corporate Service Provider Business by the Bermuda Monetary Authority.

DUBAI

Bank Lombard Odier & Co Ltd · Representative Office Dubai

Conrad Business Tower · 12th Floor · Sheikh Zayed Road · P.O. Box 212240 · Dubai · UAE · dubai@lombardodier.com

Under the supervisory authority of the Central Bank of the UAE.

ISRAEL

Israel Representative Office ·

Bank Lombard Odier & Co Ltd

Alrov Tower 11th floor · 46 Rothschild Blvd. · Tel Aviv
6688312 · Israel · telaviv@lombardodier.com

Not supervised by the Supervisor of Banks in the Bank of Israel, but by Swiss Financial Market Supervisory Authority which supervises the activities of Bank Lombard Odier & Co Ltd.

JOHANNESBURG

South Africa Representative Office ·

Bank Lombard Odier & Co Ltd

140 West Street · Sandton · Johannesburg 2196 · South Africa

johannesburg@lombardodier.com

Authorised financial services provider Registration number 48505.

MONTEVIDEO

Lombard Odier (Uruguay) SA

Luis Alberto de Herrera · Torre 2 · Oficina 2305
11300 Montevideo · Uruguay

montevideo@lombardodier.com

Supervised by Banco Central del Uruguay.

NASSAU

Lombard Odier & Cie (Bahamas) Limited

Goodman's Bay Corporate Centre · West Bay Street · P.O. Box N-4938 · Nassau · Bahamas · nassau@lombardodier.com

Supervised by the Central Bank of the Bahamas and the Securities Commission of the Bahamas.

PANAMA

Lombard Odier & Cie (Bahamas) Limited · Representative Office in Panama

Oceania Business Plaza Torre 2000 · Oficina 38-D · Blvd. Pacifica · Urb. Punta Pacifica · Corregimiento de San Francisco · Panamá · panama@lombardodier.com

Supervised by the Central Bank of the Bahamas and the Superintendencia de Bancos de Panamá.

Lombard Odier (Panama) Inc.

Oceania Business Plaza Torre 2000 · Oficina 38-D · Blvd. Pacifica · Urb. Punta Pacifica · Corregimiento de San Francisco · Panamá · panama@lombardodier.com

Supervised by the Superintendencia del Mercado de valores de Panamá. Licensed to operate as an Investment Adviser. Res. SMV No.528-2013.

ASIA - PACIFIC

HONG KONG

Lombard Odier (Hong Kong) Limited

3901, Two Exchange Square · 8 Connaught Place · Central · Hong Kong · hongkong@lombardodier.com

A licensed entity regulated and supervised by the Securities and Futures Commission in Hong Kong.

SINGAPORE

Lombard Odier (Singapore) Ltd.

9 Raffles Place · Republic Plaza #46-02 · Singapore
048619 · singapore@lombardodier.com

A merchant bank regulated and supervised by the Monetary Authority of Singapore.

TOKYO

Lombard Odier Trust (Japan) Limited

Izumi Garden Tower 41F · 1-6-1 Roppongi, Minato-ku · Tokyo 106-6041 · Japan · tokyo@lombardodier.com

Regulated and supervised by the Financial Services Agency (FSA) in Japan. It holds a trust business license (FSA No.208) and is registered with Kanto Local Finance Bureau for Financial Instruments Business Operator (No.470).

¹ Private bank and securities dealer authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).

² Branch of Lombard Odier (Europe) S.A., a credit institution based in Luxembourg, authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.