Here's How Much This Trade War Might Cost Us

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Tax and financial advisory firm RSM estimates that a full-scale trade war will cost the U.S. over $1 trillion. (Shutterstock)

Wars aren't free. That includes trade wars.

The Trump administration is currently fighting a trade war with China but also has tariffs on goods coming from Russia and Brazil. And trade relations with the European Union, while better today than they were just a few days ago, are still a tweet away from falling apart. Then there is the all-important NAFTA do-over, which is largely on hold due to recent elections.

The initial costs of the first tariffs, centered on steel and aluminum, are coming into view.

"Anecdotally, at least, we can say that manufacturers in areas that were tariffed are worried," says Patrick Chovanec, an investment strategist with Silvercrest Asset Management in New York.

So far the Trump administration has imposed roughly $105 billion of import taxes across the three large trade blocs and supply chains. Since retaliation in the early portion of the trade spat has been tit-for-tat, the additional $105 billion in global retaliation brings the early total hit on the U.S. economy to $210 billion, according to estimates by tax and financial advisory firm RSM.

"If the tariff policy is fully implemented, the costs will likely exceed $1.3 trillion with the risk of a much greater hit to the U.S. economy than many are currently anticipating and a premature end to the business cycle," says Joe Brusuelas, chief economist at RSM.

With the exception of recent ISM survey data from manufacturers, losses have yet to show up in the hard economic data. They are only anecdotal evidence of sentiment in sectors hit by tariffs. Brusuelas thinks the impact of current trade policy will begin to appear in the September and October data, especially in manufacturing, durable goods and retail, as well as in the third-quarter gross domestic product report to be published on October 26—just days before the U.S. congressional elections.

"I think Trump would be wise to score some wins in trade before November," says Scott Clemons, chief investment strategist for Brown Brothers Harriman.

If the administration follows through on all currently available tariff lines for import duties, the hit to the U.S. economy would be closer to $655 billion, based on RSM's calculations. The $1.31 trillion comes from retaliatory effects, excluding the possible effect of currency fluctuations and even competitive currency devaluations.

"Our base case presented last year indicated that setting tariffs on all available imports is the demarcation point when a trade spat becomes a full-blown trade war," Brusuelas says.

See: Trump Goes For China's Jugular — Forbes

Boom goes the dynamite! Trump tweeted Thursday that Pennsylvania has to love him because he“s “bringing steel back in a very big way.” Photographer: Victor J. Blue/Bloomberg

China threatened to slap $60 billion worth of tariffs on U.S. imports if Trump hits them with the proposed $200 billion currently being tossed around in Washington. Note that China is unable to retaliate in kind due to the massive trade gap between the two countries.

The Chinese government announced Friday that duties would range in rates from 5% to 25%. Many of the goods are agriculture-related, with others being various metals and chemicals.

“The implementation date of the taxation measures will be subject to the actions of the U.S., and China reserves the right to continue to introduce other countermeasures,” the [Ministry of Commerce said] in a press release today. “Any unilateral threat or blackmail will only lead to intensification of conflicts and damage to the interests of all parties.”

China’s latest attack comes two days after the U.S. Trade Representative said that Trump asked them to review whether a 25% duty was better than the original threat of a 10% tax on Chinese exports worth up to $200 billion. The change in percentages likely means Washington will not settle on new tariffs until the first week of

September, rather than the third week of August. The $200 billion was meant to go after China for retaliating against Washington's July tariffs of around $50 billion.

China's trade-war tactics target American farm towns, particular large commodity exporters of soy and animal proteins. Photographer: Daniel Acker/Bloomberg

According to Panjiva, S&P Global Market Intelligence, the increase to 25% is driven in part by an aim to force real change in Chinese government policy and corporate supply chains. A Panjiva survey of corporate responses to tariffs shows the 10% rate would typically be responded to by American companies increasing prices rather than behavioral changes from Beijing.

Additionally, the increase to a 25% rate could obviate the need for putting a 10% tariff on everything Made in China.

The largest individual product groups targeted by the $200 billion list include IT network equipment ($24.3 billion imported in the 12 months to May 31) and computer components ($17.6 billion). More broadly, industrial supply chains face disruptions from duties on plastics ($10.6 billion), chemicals ($9.6 billion) and metals ($10.3 billion). Significant consumer goods categories that will face duties include furniture ($29.7 billion), luggage ($8.9 billion) and home appliances ($3.6 billion), according to Panjiva research.

Investors are sticking to China, despite it being a money-loser.

China equity funds continued to soak up fresh cash in the five trading days ending Wednesday despite declines, fund-tracking firm EPFR Global said on Friday. China is the worst-performing large emerging market and represents a value to many long-only funds.

Meanwhile, China-based companies have been slowly moving their production lines to Malaysia, Vietnam and elsewhere in Southeast Asia to avoid rising wages and land costs. That's true. But nowadays they are moving in search of safe havens from the escalating trade war between China and the U.S., said Clara Chan Yuen-shan, president of the Hong Kong Young Industrialists Council and chief executive of Lee Kee Holdings. The Council represents 150 manufacturers with a combined workforce of 1 million and $25.5 billion in annual production.

"Many manufacturers have begun the relocation process of their production lines from the mainland due to rising costs and tougher regulations," she told the *South China Morning Post* this week. "The outbreak of the U.S.-China trade war escalates the wave of relocations."

As it stands, RSM doubts the present trade spat will lead to a major macroeconomic event. It will, however, produce a profoundly microeconomic supply shock as supply and value chains are disrupted and shuffled around in a game of antitax chess. Companies will be forced to renegotiate pricing as prices increase, threatening inflation and rising interest rates.

For RSM, the potential effects of the trade conflict are hard to quantify. The U.S. economy has not engaged in a trade war since the 1930s when the United States passed the protectionist Smoot-Hawley Tariff Act. Many free-traders like to cite that Act as an example of what's to come—a recession and maybe even a depression. But back then, the U.S. was a developing economy and heavily reliant on exports. Those protectionist policies were designed, in part, to help the U.S. build its industrial capacity, similar to what China has done over the last 30 years. Today, though, China is an economic superpower and a global competitor in world export markets, particularly in industrial materials and new telecommunications technologies.

Chinese President Xi Jinping: The 2017 Davos Man Man of the Year. He’s fighting a trade war some say Trump started, others say China started more than a decade ago. (AP Photo/Themba Hadebe)

This is not the 1930s. And this is not a Smoot-Hawley reboot, Brown Brothers Harriman’s CIO Clemons believes.

Still, given today’s global supply chains and deep integration of global financial markets, it is impossible to predict the overall impact, says RSM economist Brusuelas.

“The damage to the economy will depend upon the relative elasticities on both the supply and demand sides due to the tariffs, associated movements in currency valuations and overall financial conditions,” he says. “If the current conflict escalates to a full-blown trade war, businesses should expect financial conditions to tighten noticeably.”

Worst case: Rising rates mean an inverted yield curve, which means a recession in the works.

Barclays Capital forecasts economic growth in the U.S. and the global economy at least until 2020, despite slowing from current highs helped by fiscal stimulus and still low interest rates worldwide.