

US-China trade tension: what to watch out for from here**Monday, March 05, 2018****Highlights:**

- The Steel and aluminium tariff following the investigation of Section 232 of the Trade Expansion Act of 1962 have limited impact on China.
- Whether it will escalate to a full blown up trade war between US and China will probably depend on two factors including the result of Section 301 investigation and China's reaction.
- As compared to 2010 when Obama Administration launched Section 301 investigation targeting at China's green technology, this round of investigation has a much wider impact as it challenges China's "made in China 2025" ambition.
- We expect China to recompense injury with kindness with further openness of its domestic market as soft approach to the latest trade tension.
- The risk of retaliation cannot be ruled out. Market should watch more closely on whether China will launch investigation on imports of US soybean, which is one of the top US products to China.
- Deadline for Section 301 investigation is mid-August but it may be released much sooner. The USTR will hold a public hearing on special 301 on 8 Mar. The new Taiwan Travel Act will add more uncertainty. Market volatility may heighten in the coming weeks.

Corporate FX & Structured
Products
Tel: 6349-1888 / 1881

Fixed Income & Structured
Products
Tel: 6349-1810

Investments & Structured
Product
Tel: 6349-1886

Interest Rate Derivatives
Tel: 6349-1899

Treasury Research & Strategy
Tel: 6530-4887

Tommy Xie Dongming

+(65) 6530 7256

xied@ocbc.com

US President Trump's announcement last Thursday that he would formally announced 25% tariff on steel imports and 10% on aluminium imports from all countries this week ahead of mid-April deadline shocked the global market. Although certain exemptions could be considered for tariff on steel and aluminium imports according to Trump's top trader advisor Peter Navarro, the trade war threat from Trump clearly shows the escalation of global trade tension.

The direct impact of the tariff on steel and aluminium imports on China is very limited as China's exports of steel and aluminium to US only accounted for 0.2% of China's total export much lower than those in Brazil and Canada. However, the tariff on solar cell and washing machine announced in late January following the Section 201 investigation and the latest tariff on steel and aluminium following the Section 232 investigation showed the worrying escalating trend. Whether it will escalate to a full blown up trade war between US and China will probably depend on two factors including China's retaliation and the result of Section 301 investigation.

Trump's trade remedy tools

The Trump Administration is currently relying on four types of remedy tools to address US's trade deficit with China including the usual antidumping and countervailing duty investigation, Section 232, Section 301 and Section 201. According to the US Trade Representative, in the first year of Trump Administration, the Administration initiated 84 antidumping and countervailing duty investigations, a 59% increase year-on-year.

Trade tools	Description	Results
Antidumping & Countervailing Duty	In November 2017, the US Commerce Department self-initiated investigation on imports of alloy aluminium sheet from China, first self-initiations in over 25 years.	Pending
Section 201 of the Trade Act of 1974	Investigating cases brought by US solar and washing machine industries on whether import caused serious injury to domestic sectors.	Significant tariff hikes on US imports of solar cells and wash machines, first time in 16 years.
Section 232 of the Trade Expansion Act of 1962	In early 2017, investigation into whether imports of steel and aluminium threatens to impair the National Security	Tariffs on both products.
Section 301 of the Trade Act of 1974	In August 2017, the Administration self-initiated an investigation acts of China related to technology transfer, intellectual property and innovation.	Pending

Source: USTR, OCBC

Watch out for Section 301 investigation

On 18 August 2017, the USTR initiated an investigation on whether China's laws, policies or practices may harm American intellectual property rights, innovation or technology development. The decision will be made within 12 months from the initiation. As such, the deadline for Section 301 will be August 2018.

Section 301 investigation is not new to China. Since 1990s, the US has launched the Section 301 investigation on China a few times. The latest was in 2010 under Obama Administration targeting at China's green technology, which resulted in WTO dispute. The dispute was eventually solved after China agreed to stop subsidizing program.

As compared to 2010, this round of Section 301 investigation has a much wider impact as it challenges China's "made in China 2025" ambition. The USTR mentioned in its report that "The acts, policies, and practices of the government of China directed at the transfer of U.S. and other foreign technologies and intellectual property are an important element of China's strategy to become a leader in a number of industries, including advanced technology industries, as reflected in numerous industrial policy initiatives, including, China's "Made in China 2025" industrial plan."

The section 301 grants President power to impose penalty such as suspending trade agreement concessions and imposing tariffs or other import restrictions etc. Should the result of section 301 investigation on intellectual property are unfavourable to China, President Trump may threaten

to impose tariffs on wider range of imports in multiple industries. This may increase the risk of trade war significantly.

Recompense injury with kindness?

The visit by two China's Politburo Members Yang Jiechi and Liu He to the US within one month clearly showed China's efforts to de-escalate the tension. In addition, the Financial Times also reported that both President Xi Jinping and Wang Qishan have summoned US Ambassador in Beijing privately to discuss about trade issue.

As mentioned by Liu He clearly in Davos World Economic Forum in January this year, China will further open its domestic market despite setback of globalization. We expect this tone to be unchanged and China is likely to recompense injury with kindness as soft approach to the latest trade tension.

Although China shows its effort to water down the tension, it has also been preparing for the worst. China has launched investigation into imports of US sorghum, in reaction to the tariff on solar cell and washing machine. However, as the absolute value of sorghum exports is very low, the move is more symbolic.

Market should watch more closely on whether China will launch investigation on imports of US soybean, which is one of the top US products to China. Should China start to target soybean, the risk of escalation may heighten.

Timeline to watch out for

President Trump is expected to sign the new Taiwan Travel Act sometime this week. In addition, the office of the US Trade Representative (USTR) will hold a public hearing on special 301 on 8 March which requires the USTR to "identify countries that deny adequate and effective intellectual property rights protections or fair and equitable market access to US persons who rely on intellectual property protection." The 2018 special 301 report will be published by 30 April.

Although the deadline for ongoing section 301 investigations will be mid-August, it is highly likely the result may come out sooner. As such, market should closely monitor the development of trade tensions, which may be one of the key sources of global volatility in the coming weeks or months.

To conclude, we think the recent trend of trade tension is worrying, although the steel and aluminium tariff have limited impact on China's trade, the upcoming Section 301 investigation could be a much bigger concern. We expect China to recompense injury with kindness with further openness of its domestic market as soft approach to the latest trade tension. However, the risk of retaliation from China cannot be totally ruled out.

This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. OCBC and/or its related and affiliated corporations may at any time make markets in the securities/instruments mentioned in this publication and together with their respective directors and officers, may have or take positions in the securities/instruments mentioned in this publication and may be engaged in purchasing or selling the same for themselves or their clients, and may also perform or seek to perform broking and other investment or securities-related services for the corporations whose securities are mentioned in this publication as well as other parties generally.

Co.Reg.no.:193200032W