

Washington Policy Research

**Washington Policy: Trade War Back On (For Now)**

The Trump Administration's decision to reinstate the steel and aluminum tariffs against Canada, Mexico and the European Union is a restart to the trade wars that had been previously placed "on hold" and highlights the continued volatility we should expect in the coming months. The latest round of tariffs are once again seen as a negotiating tactic to reach a deal on other Trump Administration priorities – such as NAFTA. What is less clear is the end game for the increased tariffs with the European Union (including the recently announced investigation on car tariffs) – as there is no clearly defined endgame. Administration officials are quick to point to the fact that there is still room for negotiation, which keeps our view that these fights are part of a larger push to win concessions on Trump's priority. That remains the base case, but the more back and forth on these issues will raise concerns about the ability to close a deal.

Steel and aluminum tariffs. Starting June 1, Canada, Mexico and the European Union will have a 25% tariff on steel imports to the United States and a 10% tariff on aluminum. The Trump Administration had previously exempted/delayed tariffs on these countries as they were deemed allies whose steel and aluminum production was not a threat to U.S. national security. These countries are now expected to retaliate with tariffs on U.S. exports in a dollar amount equivalent to the expected U.S. tariffs. This is allowed under WTO rules. It appears that Trump wants to increase the pressure to reach a NAFTA deal, which has been at a standstill in recent weeks. This follows the initiation of an investigation on car tariffs last week, which we also viewed as an effort to jumpstart these talks.

Battle of free traders vs. hardliners. These headlines are part of a larger internal battle that is going on within the Trump Administration between free traders and hardliners. We place Treasury Secretary Mnuchin as the leader of the free traders and when he has the ear of the President, the market receives favorable trade headlines. In the other camp are Commerce Secretary Wilbur Ross, US Trade Representative Robert Lighthizer, and White House Trade Policy Advisor Peter Navarro. When they are leading the agenda, we generally have headlines and positions coming out of the White House that take a harder line on trade issues. In this latest round, Commerce Secretary Ross is leading the efforts.

What about China? The Trump Administration's memo earlier this week that outlined the continued march towards implementing the \$50 billion in tariffs and potential investment restrictions reportedly caught China by surprise. Commerce Secretary Ross is headed to Beijing and the expectations have been that his trip will finish with a deal on reworking the sanctions on ZTE. We continue to maintain this expectation and note that the current anti-trade actions take the spotlight away from the political pushback that Trump was receiving related to ZTE. There is an argument to be made that China should be incentivized to continue to work towards a deal as the Trump Administration is demonstrating their continued commitment to ramp up the trade fights if an agreement is not reached. If we do have a concern, it is in the fact that Wilbur Ross is leading this trip rather than Mnuchin.

Next steps. We believe the on again, off again trade headlines are likely to persist for several months. We see a negotiated solution and the long-term avoidance of tariffs as the most likely outcome. The threat of a misstep remains, which should contribute to market volatility.

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