Trade war fears hit global markets

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Rising trade tensions yesterday produced the biggest fall in US stock markets since early April with the Dow down by more than 300 points for the day after falling by 500 points at one stage. The S&P 500 index was off by 1.4 percent and the tech-heavy Nasdaq index dropped by 2 percent.

The fall on Wall Street followed a drop in markets in Asia and Europe. The European STOXX 600 index dropped 2 percent, the British FTSE index was down by more than 2 percent in its worst trading day since February and the German Dax index fell 2.4 percent.

The immediate cause for the fall in markets appears to have been the reaction to plans by the Trump administration to prevent companies that have at least 25 percent Chinese ownership from buying businesses in the US that possess "industrially significant technology" and that these measures could extend more broadly.

With the markets falling, White House economic adviser Peter Navarro gave an interview to the business channel CNBC during the last hour of trading. He said there were "no plans to impose investment restrictions on any countries that are interfering in any way with our country."

Navarro, the leading anti-China hawk in the administration, said the only thing happening in the near term was that on Friday Treasury Secretary Steven Mnuchin "is going to report to the president on the issue related to China. That's all that's going to happen. With respect to other countries, there's absolutely nothing on the table."

This was in direct contradiction to an earlier tweet by Mnuchin, in which he stated that investment restrictions would not be China specific but would be directed to all countries investing in US technologies.

"Statement that will be out not specific to China, but to all countries that are trying to steal our technology," he wrote.

White House press secretary Sarah Huckabee Sanders, speaking at her daily press briefing after Navarro had given his CNBC interview, said: "As the secretary said, a statement will go out that targets all countries that are trying to steal our technology."

The divergent statements on what exactly is being planned point to a conflict within the Trump administration over how measures against investment by China in US technology are to be carried out.

It has been widely reported that the Trump administration plans to invoke powers under the International Emergency Economic Powers Act (IEEPA), which allows the president to impose sanctions on the grounds of a "national emergency" previously used against countries such as North Korea and Iran.

The position of Navarro and US Trade Representative Robert Lighthizer is that the key issue is not the US trade deficit but Beijing's efforts to develop its technological base under its "Made in China 2025" plan. This constitutes an existential threat to the US both on the economic and military fronts.

Under a proposal backed by Mnuchin, measures directed against China and possibly other countries would be implemented through the strengthening of the powers of the Committee on Foreign Investment in the United States (CFIUS), which comes under the Treasury Department. Mnuchin is reported to have argued that new CFIUS legislation, which is making its way through Congress, would give the agency all the powers that are needed.

According to a report in the *Financial Times*, however, "people both inside and outside the administration familiar with the situation" say that "the China hawks have won an internal debate."

Peter Harrell, who worked in the State Department in the Obama administration and drafted sanctions legislation, told the newspaper use of the IEEPA would continue the policy of the Trump administration in invoking national security as the basis of its trade measures.

"The Trump administration, kind of across the board, has very much blurred the line and seems to be saying that any significant economic challenge the US faces is also a national security challenge," he said.

The record of the administration is in line with this assessment. The tariffs imposed on steel and aluminium, which infuriated Europe and Canada and led to a split at the G7 summit meeting earlier this month, were invoked under a "national security" provision of the 1962 Trade Expansion Act.

Trump has also ordered an investigation into auto imports under the same legislation. If similar tariffs were imposed they would have a major impact, especially on the German car industry, which has said no vehicle exported to the US would be able to be sold at a profit.

The European Union is clearly expecting an escalation in US trade war measures. According to an internal memo cited by Bloomberg, circulating among EU governments, the entire system of international commerce is set to revert to one in which the strong impose their will upon the weak.

In clear reference to the threat against auto exports, the memo, drafted by the European Commission that has responsibility for trade policy, said disputes between the US and its trading partners were set to escalate "in the coming months, as more unilateral measures are threatened and imposed, leading, in some cases, to countermeasures, or to mercantilist deals."

It warned that the international trading system would go back to an "environment where rules are only enforced where convenient and where strength replaces rules as the basis for trade relations."

In Beijing, the Chinese government is giving clear indications that it is preparing for such a situation as a result of the US measures.

At a meeting with executives from 20 European and American multinational corporations held last week, Chinese president Xi Jinping is reported to have indicated that China was ready to strike back against the US.

"In the West, you have to notion that if somebody hits you on the left cheek, you turn the other cheek. In our culture we punch back," he said, according to people briefed on the event.

The *Wall Street Journal* cited a senior official who said: "China is not going to yield to outside pressure and eat the bitter fruit. That's the negotiating principle set by President Xi."

China is looking for allies in the trade war against the US, particularly the European Union. Following talks held with the European Commission Vice President Jyrki Katainen yesterday, Chinese Vice Premier Liu He said they had agreed to defend the multilateral trading system.

"Unilateralism is on the rise and trade tensions have appeared in major economies. China and the EU firmly oppose trade unilateralism and protectionism and think these actions may bring recession and turbulence to the global economy," he told a joint press conference.

The EU and China have set up a working group to update the World Trade Organisation on the new situation, Katainen said. The two sides will also exchange a list regarding a bilateral investment agreement. While this did not mean accord would be reached immediately because of cyber security and technology transfer issues, Katainen said it was "a big step forward."

In the US, Commerce Secretary Wilbur Ross has shrugged off claims that the Trump trade war measures could have a significant impact on the US economy.

"Anyone who thinks the economy is being wrecked doesn't know what they're talking about," he said in a Bloomberg Television interview. Asked to respond to comments by US Federal Reserve chairman Jerome Powell that trade conflict could weigh on the outlook for global growth, Ross said: "I don't think that's true, that there's some big change."

But change is starting to happen. Harley-Davidson has announced that it is shifting production of motorcycles destined for Europe out of the US in response to the EU's decision to impose tariffs in response to the US tariffs on steel and aluminium.