Trump, China tariffs and the Wall Street bubble

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US President Trump appears once again to have flipped on his latest threat to impose an additional 100 percent tariff on Chinese goods following a decision by Beijing to introduce export licensing on the supply of rare earth products.

After issuing fire and brimstone comments last Friday morning in response to the Chinese decision—some of his most bellicose in the tariff war—Trump was singing from a different song sheet as he made his way to the Middle East over the weekend.

"Don't worry about China, it will be all fine! Highly respected President Xi just had a bad moment. He doesn't want Depression for his country, and neither do I. The USA wants to help China, not hurt it!!!" he wrote in a social media post.

The cause of the apparent rapid backpedaling was the reaction in the markets. Before Trump's tariff threat on Friday, Wall Street had been heading for another record high. By the end of the day, it had experienced its worst fall since it dropped sharply in April in response to Trump's unveiling of his "reciprocal tariff" plan and major retaliatory measures against China.

The S&P 500 index fell by 2.7 percent, wiping $2 trillion off its total market capitalization, the tech-heavy NASDAQ index was down 3.6 percent, and around $400 billion was wiped off the crypto market. Two of the biggest market falls were the chipmakers Nvidia and AMD which are at the center of the AI boom powering Wall Street. Their shares were down 5 percent and 8 percent respectively. The markets then moved back up after the shift in Trump's rhetoric.

The sharp reaction to the China tariff threat is only one expression of the extreme fragility of the present debt-fired Wall Street boom and the growing fears that the inflated bubble could soon burst amid a breakdown of international economic relations.

The impact of the US-China trade war on the global economy was highlighted in comments earlier this week by copper mining billionaire Robert Friedland, the head of the Canadian firm Ivanhoe Mines, to the *Financial Times* (FT).

Speaking at the start of an annual meeting of mining industry executives and traders, he echoed the sentiments no doubt held by many in this and other industries when he said rising global tensions were leading to a "breakdown in the international order."

"These tensions are Balkanizing the world economy, and we see it in the copper industry. We have very significant global tensions developing … Unlike anything I've seen."

The US-China trade war, at the center of which is the production of ever-more advanced computer chips and rare earth materials needed to make them, is intimately connected to one of the key economic issues of the day—the development of artificial intelligence and who will control and dominate it.

The development of AI contains the potential for economic advances and a major boost in the productivity of human labor in every area. But it is not being advanced in a rational and planned manner but in accordance with the laws of profit and the capitalist market, leading to a boom on Wall Street powered by increasingly risky operations.

There are mounting concerns that the complex financial mechanism through which it is being developed has created a financial bubble, the bursting of which would have far greater consequences than the collapse of the dot-com bubble at the start of the century.

While they reported bumper profits, three major US banks—Goldman Sachs, JP Morgan Chase, and Citigroup—warned of developing risks.

"We have a lot of assets out there, which look like they're entering bubble territory," JP Morgan chief Jamie Dimon said.

Concerns about the boom in AI and related stocks were summarized in an FT editorial earlier this week.

"The artificial intelligence boom," it began, "is entering a new and riskier phase." Up until now, the expenditure on chips and data centers had been financed by "hyperscalers"—the tech giants—though their vast internal cash balances.

"But the projected scale of computing power for generative AI is now prompting a shift towards more leveraged, opaque and circular financial structures, which raises the economic stakes riding on the technology's success."

While the tech giants still enjoyed higher ratings, it said, debt is being channeled into projects for non-investment grade borrowers including OpenAI, the developer of ChatGPT, and smaller AI start-ups with some agreements involving "complex circular financing arrangements."

Two of the most prominent examples are the deals involving OpenAI. In an agreement with the leading AI chipmaker, Nvidia, it is obtaining finance part of which will be used to buy Nvidia chips. In the deal with another chipmaker, AMD, it will obtain shares in the company for one cent and then, as AMD stocks rise, be able to cash them in to obtain the finance to buy the company's chips.

The FT editorial noted that both the Bank of England and the International Monetary Fund have warned that tech valuations are approaching the dot-com extremes, giving rise to a "sharp correction" in global equities and that a "sudden reversal would hit investment funds, pensions, and retail portfolios."

And they would not be the only ones impacted because the "growing reliance on debt, particularly from lower-quality users, now also leaves banks and the highly leveraged non-bank sector exposed to any defaults. Incestuous bilateral funding deals can only amplify the risk of domino effects."

In short, contained in the mechanisms being used to develop AI is the potential for a full-blown financial crisis, impacting every area of the economy.

The use of complex debt and financing arrangements is not confined to the development of AI. It extends across the financial system and has been brought into sharp focus with the bankruptcy of the auto parts firm First Brands.

Total losses from the collapse will run into at least $10 billion. This week a court filing by one of the company's creditors said as much as $2.3 billion in trade finance assets had "simply vanished."

The major issue is not so much the amount of money involved, significant as that is, but what financiers were involved and what the First Brands experience indicates about the operations of the broader financial system and the rise of private credit.

Those involved in the financing of First Brands, a company with very little public profile and whose operations as a private firm were largely concealed, included some major names: Jefferies, the New York investment bank which organized much of the financing; an offshoot of the Swiss Bank UBS that provided a large amount of money; and BlackRock which provided money to an intermediary which lent it to First Brands.

The First Brands losses are not enough to cause a systemic crisis, or at least so far it does not appear so. But Jefferies management was forced to issue a statement that it was "confident that any losses or expenses" arising from its investments, estimated to be around $715 million, could be readily absorbed and would not "threaten our financial condition or business momentum."

That may be the case. But the fact that such a statement had to be issued was, as is always the case, an indication that there were concerns. And they extend beyond First Brands.

As a comment in the *Australian Financial Review* noted: "The fact that this episode is playing out in public has many worrying about what's happening behind the scenes in the opaque world of private credit."

The share prices of private capital giants including Blackstone, KKR, Ares Management, and Apollo Global Management have fallen by 20 percent in the past three weeks.

Well-known Wall Street short seller Jim Chanos told the FT earlier this month that the collapse of First Brands was sounding the alarm on the private credit debt boom which has played a decisive role in the Wall Street surge.

He likened the $2 trillion private credit operations to the packaging up of subprime mortgages which sparked the financial crisis of 2008.

From tariffs and trade to the financing of AI and the growth of private credit and the financing of a debt-led boom, the signs are starting to flash red on Wall Street.