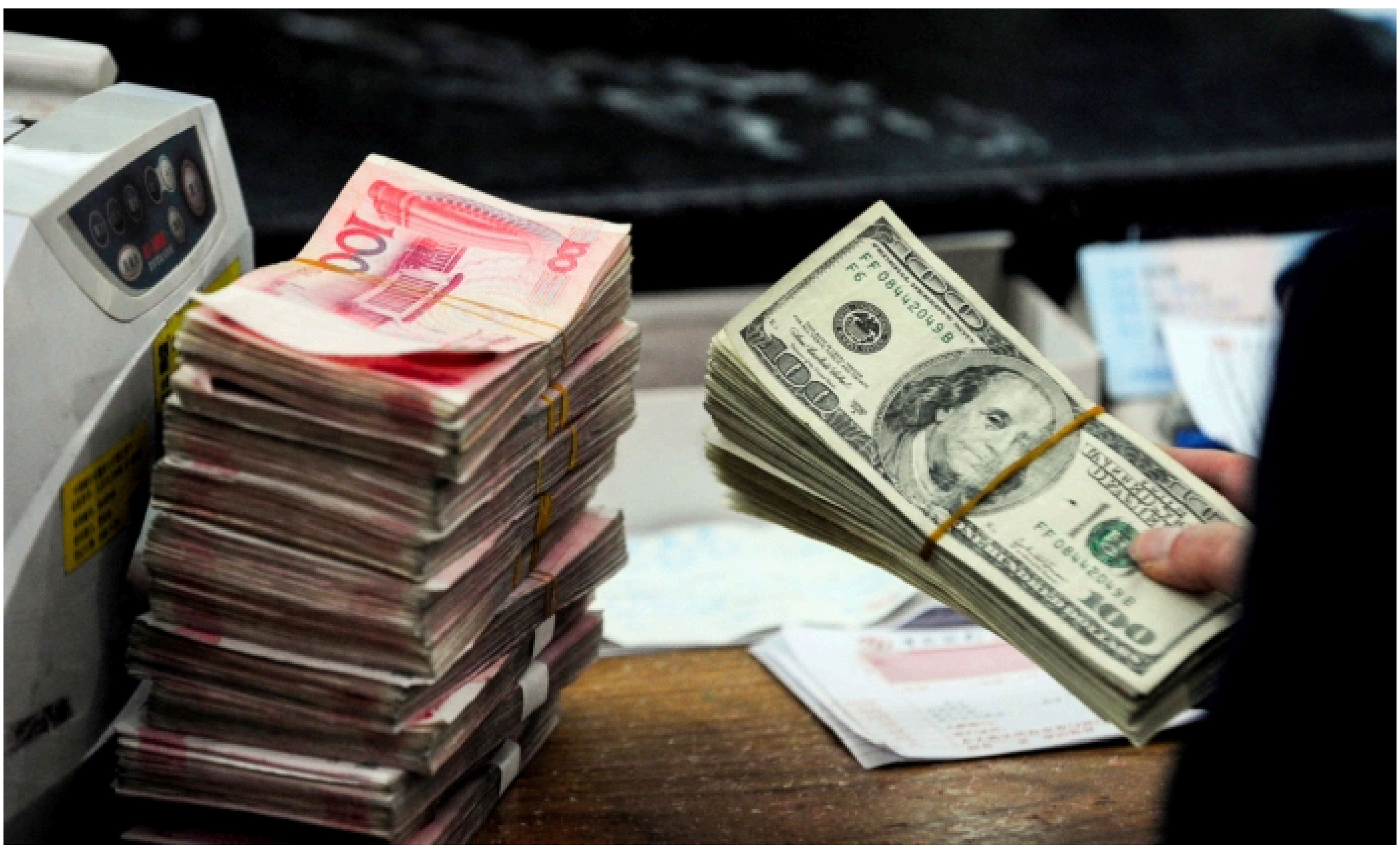
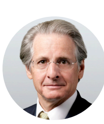
Impact of Trump's Upcoming China Tariffs Will Depend on Currency Reaction

Beijing must brace for it: Trump will almost surely raise U.S. tariffs on Chinese imports.



A Chinese bank worker prepares to count U.S. dollar bills and a stack of 100 yuan notes at a bank in Hefei, Anhui Province, China, in a file photo. STR/AFP via Getty Images



By Milton Ezrati
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Commentary

Donald Trump will become president of the United States in January, and the tariffs he promised to put on Chinese imports will almost certainly follow soon thereafter. They will impact China's already beleaguered economy hard.

The nature of that impact will depend, however, on how foreign exchange markets react. Movements there could mitigate any inflationary effect on the United States and export levels in China.

Trump has promised broad tariffs between 10 percent and 20 percent on all imports to the United States and tariffs between 60 percent and 100 percent on China-based imports. That sounds pretty steep, and it is, but in context, it is less radical than it might sound.

President Joe Biden, who criticized Trump's tariffs during the 2020 election campaign, not only maintained those tariffs from 2018–19 but also expanded them. Biden already has a 100 percent tariff on Chinese electric vehicles (EVs) and parts, as well as batteries. He has also placed non-tariff barriers on U.S.–China trade, especially on technology such as advanced semiconductors.

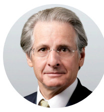
Anticipating Trump, American buyers in China had begun to move even before the election results were clear. In the weeks before the election, American retailers and manufacturers began to front-load their purchases of Chinese finished goods and inputs to get them into the country before the tariffs imposed any additional costs. The same thing happened in 2018 in anticipation of the first round of Trump tariffs. Back then, the sudden rise in Chinese imports was so significant that it pushed up ocean carrier shipping rates by some 70 percent. This time, shipping rates have not yet responded, but surely the recent rise in Chinese exports owes something to this effect. However far this immediate demand goes, it is by nature only a one-off thing. It will first make Chinese exports look stronger than they fundamentally are. Then, the inventory buildup from the front loading of purchases will create a sudden drop after the tariffs go into effect, exaggerating the impact of the tariffs for a while. It will probably take months after the levies go into effect to get a clear picture of trade flows.

Once the tariffs go into effect, their impact on China and the United States will depend in large measure on reactions in foreign exchange markets. In 2018, the Chinese yuan fell steeply against the U.S. dollar right after the Trump administration implemented the tariffs. The yuan continued to fall for months, dropping some 10 percent against the dollar over 2018 and 2019. This currency change cut the dollar price of Chinese goods to Americans more than enough to offset some two-thirds of the costs imposed by the tariff increases. Accordingly, American buying of Chinese goods remained high. Volumes actually rose some 12 percent a year in 2018 and 2019.

Of course, these moves meant that Chinese producers received fewer dollars for their products than before the tariffs and the exchange rate changes. Their revenues and profits fell accordingly, even as sales volumes increased—the Chinese, not the American buyers, paid for the Trump tariffs. Because of the drop in the dollar price of Chinese goods, the then-popular forecasts of inflation missed the mark. Because the yuan's drop made Chinese goods cheap even after the tariffs went into place, Trump's objective to cut off the flow of Chinese goods did not come to pass.

Because the tariffs will be higher this time, a similar offset would require more of a yuan move. Perhaps a yuan drop of 18–20 percent would be sufficient. That would put the yuan at about 8.5 to the dollar. So far, the yuan has not moved in this direction, and it is not apparent that the authorities in Beijing will let it happen. They have, of late, resisted yuan depreciation out of fear that it will prompt capital outflows from China. However, they may have to allow the yuan to depreciate to sustain export volumes, which the economy needs. If the yuan fails to depreciate, the tariffs will impose on China a marked drop in exports to the United States and, unlike in 2018 and 2019, Americans will suffer inflationary effects. The currency reaction will determine the outcome.

Views expressed in this article are opinions of the author and do not necessarily reflect the views of The Epoch Times.



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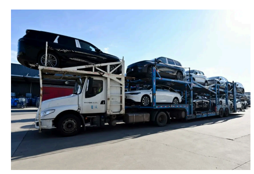

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