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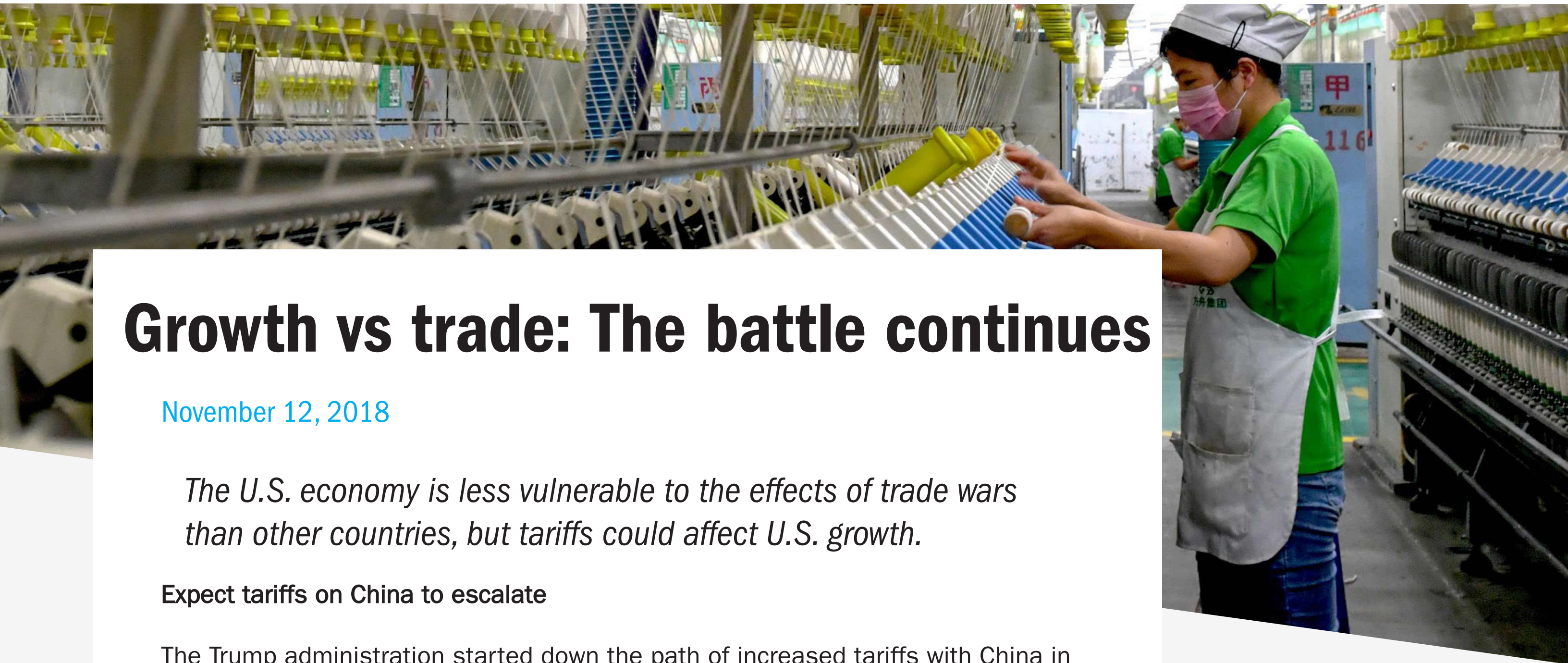


Growth vs trade: The battle continues

November 12, 2018

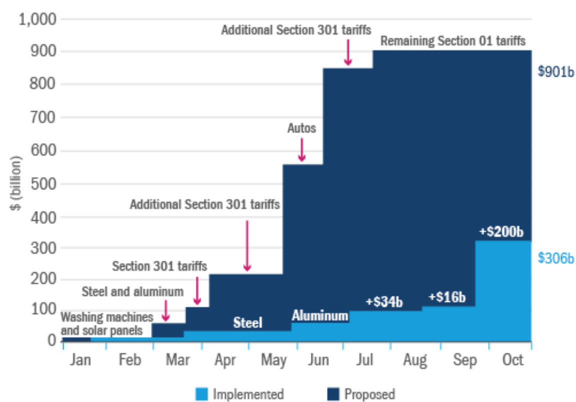
The U.S. economy is less vulnerable to the effects of trade wars than other countries, but tariffs could affect U.S. growth.

Expect tariffs on China to escalate

The Trump administration started down the path of increased tariffs with China in early 2018 by announcing tariffs on steel and aluminum imports and Section 301 tariffs on $50 billion of Chinese imports. Then, on September 24, it implemented tariffs on an additional $200 billion worth of Chinese goods. We believe this path could continue and the imposition of tariffs on all Chinese imports is likely in the next couple of months. Senior Porfolio Manager, Head of Multi-Asset Strategy

Anwiti Bahuguna, Ph.D.
Senior Porfolio Manager, Head of Multi-Asset Strategy

U.S. tariffs: proposed and implemented



Source: Macrobond, Goldman Sachs Global Investment Research, USITC, Department of Commerce and Columbia Threadneedle Investments. Data as of 10/31/18.

Expect a moderate slowdown on U.S. growth

The consensus is that tariffs will slow growth by approximately 0.2% in the U.S. The impact on inflation will also most likely be manageable, but we shouldn't be complacent if the magnitude of these tariffs continues to rise and tensions escalate. Tariffs are essentially a tax on imports and will increase import prices for goods in the U.S., including the price of intermediate goods that are used in creating the final products and services that are sold to consumers and businesses. If producers in the U.S. elect to pass on the increased cost of inputs, then we should expect to see a rise in inflation. However, firms faced with higher input costs typically try to find

savings elsewhere or they do what they can to absorb the increased costs. Therefore, import costs don't always equate to a one-to-one increase in the price of final goods and services, and the effect to inflation is expected to be manageable.

Meanwhile, U.S. economic data continues to signal good growth:

- Payroll growth remains strong and is steadily bringing down the unemployment rate.
- Future indicators of growth like the ISM Purchasing Managers Index continue to be elevated, and both consumer and business sentiment is high.
- Wage growth has picked up, although at roughly 3% it's still moderate by historical standards.

Federal Reserve Board Chairman Jerome Powell recently commented that the economic environment could not get any better than this when growth is strong and inflation is moderate. The Fed also believes that there is little slack in the labor market at a 3.7% unemployment rate. It's looking to raise the overnight rate steadily, barring any exogenous shocks to the economy. Despite rising bond yields, escalating trade tensions and a slowdown in global growth, U.S. financial conditions have remained supportive of this action by the Federal Reserve.

The U.S. is in a better position than China

The market seems to have also concluded that, vis-à-vis tariffs, the U.S. is in a stronger position than the rest of the world — particularly China. This is reflected in the divergence in U.S. and China stock market performance.

Growth of a dollar and yuan invested in U.S. and Chinese equity markets

Source: Columbia Threadneedle Investments. Data as of 10/11/18. The China Securities Index 300 (CSI 300) represents the performance of the top 300 stocks traded in the Shanghai and Shenzhen stock exchanges. The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization U.S. stocks. It is not possible to invets directly in an index.

Bottom line

Growth is strong in the U.S., and this trend is likely to continue in the fourth quarter, but it will probably decelerate in 2019 when the positive effects of tax cuts and fiscal stimulus fade. We believe trade tensions and increases in the federal funds rate are here to stay and will be a source of continued market volatility in the near term.

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