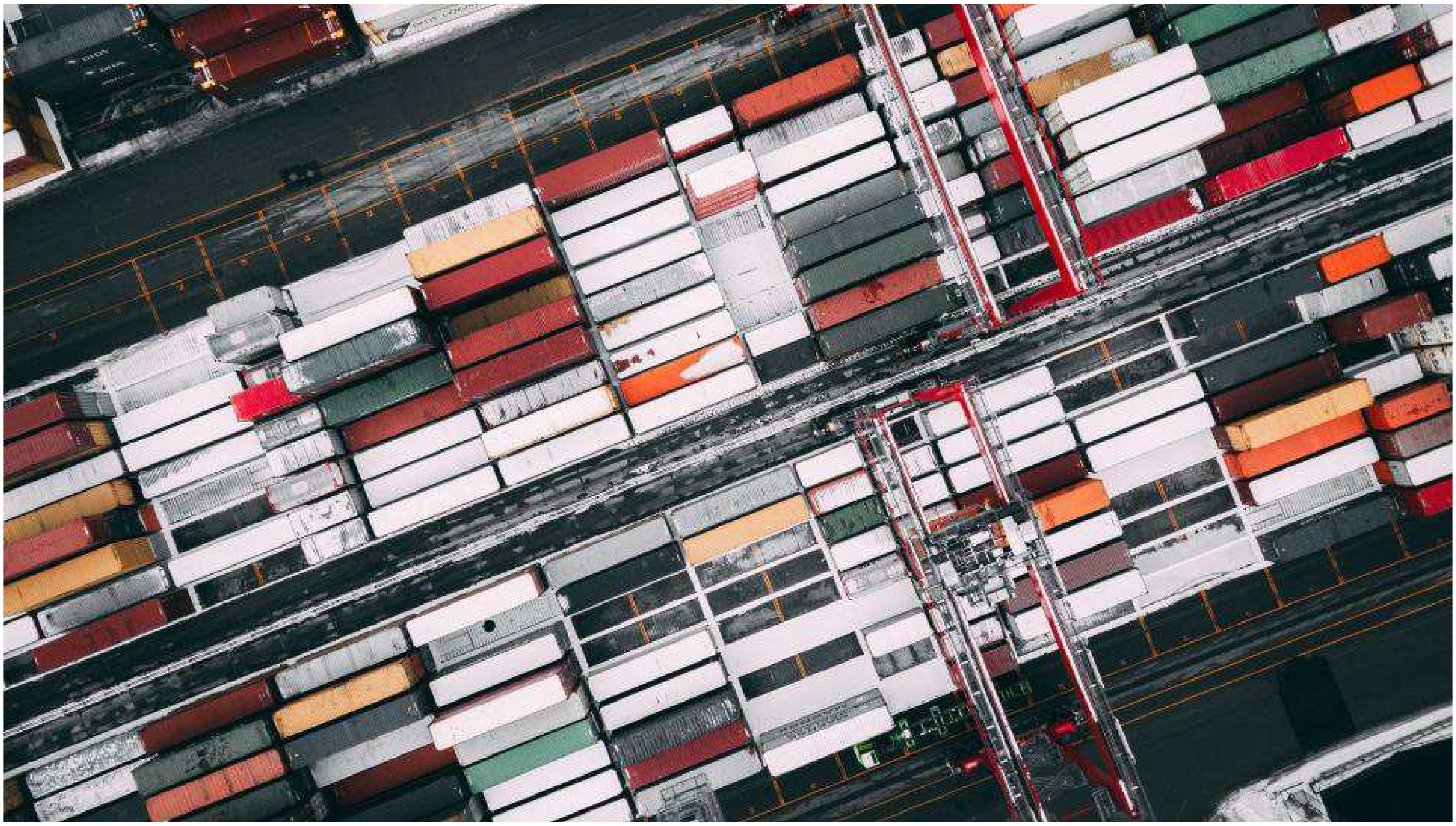

Trade Wars Episode V: The Middle Kingdom Strikes Back

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Summary Overview: This is *Trade Wars Episode V*, an ongoing series of BAMKO White Papers exploring the scope and potential impact of U.S. tariffs on Chinese imports. Part 1, Part 2, Part 3, and Part 4 can be found via the hyperlinks.

What's Happening: Nothing good. On August 1, 2019, President Trump announced that come September 1, 2019, a 10% tariff would be levied on approximately $300 billion in Chinese goods. This round of tariffs (the "List 4 Tariffs") is the most expansive in scope to date and means that virtually all goods imported from China into the U.S. will be subject to tariffs.

On Monday, August 5, 2019, the Chinese government responded by allowing the yuan to breach the "psychologically important level of 7 yuan to the dollar," setting a record low in offshore trading for the Chinese currency. In addition to allowing its currency to cross a symbolically important redline, China is halting purchases of new agricultural products in a bid to take direct aim at Midwestern farmers, a key bloc of Trump electoral support. Late Monday, the U.S. responded by labeling China a currency manipulator, a largely symbolic countermeasure.

Note: Scale inverted to show a depreciating yuan.
Source: Tullett Prebon

Observers view China's response as a significant escalation, opening up a new and potentially volatile front that officially expands the conflict beyond the tit for tat imposition of reciprocal tariffs. On Monday, the Dow sank 760 points, the biggest single day drop of 2019, as traders braced for a protracted and costly conflict.

Source: https://twitter.com/CNBCnow/status/1158468507446759424?s=20

Inarguably, the latest exchange marks a new low point in U.S.-China trade relations. Both sides are ratcheting up the pressure and China's retaliation is seen as an indication that it is not seeking a near-term resolution. As of this writing, no further escalation appears imminent, but neither side is ruling it out. Should the United States wish to respond with something more forceful than labeling China a currency manipulator, it could ratchet up the rate on List 4 Tariffs from the proposed 10% rate to 25% (or higher). Glass half-full types will point to still scheduled September trade talks as grounds for optimism.

What is certain is that escalating tensions will have a negative impact on the pocketbooks of U.S. businesses and consumers. Weakening the yuan has the effect of shifting *some* of the burden of tariffs to Chinese consumers and U.S. producers more broadly. A weakened yuan notwithstanding, U.S. consumers will likely end up bearing the brunt of increasing product costs resulting from the List 4 Tariffs.

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How We Got Here: President Trump swept into office with a mandate to realign what were perceived as imbalanced global trade relationships. Right or wrong, Trump set his sights on China, the U.S.'s biggest trading partner and, indisputably, a state actor that has been willing to bend the rules to serve its own nationalist agenda.

A recap of events to date:

July 2018: List 1 Tariffs - The U.S. and China impose reciprocal tariffs on $34 billion of each other's goods.

September 2018: List 3 Tariffs - The U.S. imposes tariffs on $200 billion of Chinese goods and China responds with tariffs on $60 billion in U.S. goods.
May 2019: The U.S. and China both *raise the rate* on List 3 Tariffs from 10% to 25%.
June 2019: President Trump and President Xi Jinping of China hold discussions at the G20 Summit, giving rise to optimism for a resolution.
August 2019: List 4 Tariffs - The U.S. announces tariffs on the remaining $300 billion in Chinese goods. China responds with currency gamesmanship and halting of agricultural purchases, signaling the opening of two new fronts in the expanding trade conflict.

What's Included in the List 4 Tariffs: The first 3 rounds of tariffs were intentionally designed to minimize their direct impact on American consumers. By definition, that means that the List 4 Tariffs include a number of consumer products that are going to impact the American public. The **list of products** this time around include items such as apparel, toys, drinkware, consumer electronics, and office products. The fact that all Chinese imports will now be subject to tariffs means the impact will be felt in all sectors of the U.S. economy. This round will have effects that reverberate throughout the retail and promotional products industries.

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New Fronts Open Up: As we've been pointing out for nearly a year, it was always inevitable that continued escalation of this trade fight would necessarily extend to new fronts. China simply does not import enough U.S. goods to be able to keep pace with reciprocal tariffs in a tit for tat exchange.

To date, the U.S. has imposed tariffs on approximately $250 billion in Chinese goods. In response, China has imposed tariffs on approximately $110 billion in American goods. As the U.S. prepares to impose tariffs on the remaining $300 billion in Chinese goods, Beijing faces a serious dilemma: there remains only about $10 billion in U.S. goods yet to be tariffed. China is left scrambling to find a tit that can measure up to the Trump administration's next tat. Apparently, it has landed on the devaluation of its own currency, a risky play that could lead to an exodus of foreign capital.

In addition to weakening the yuan, Beijing could look to inflict pain with intrusive government inspections, bureaucratic delays in licensing, and **other non-tariff measures**. However, China would be wise to tread lightly, as it risks scaring off foreign investment in an already slowing economy. With multinational firms increasingly looking for manufacturing options outside of China, most of China's retaliatory measures risk cutting off their own nose to spite their face.

What's Next: Who the heck knows? The usual cadre of crystal ball merchants are wallowing in a state of self-inflicted ignominy after having been consistently wrong about nearly every aspect of this conflict for over a year. Over the last year, we've seen threats, escalations, de-escalations, and concessions arrived at with nary a rhyme or reason. Don't go chasing waterfalls by looking for predictability where none exists.

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Suppliers are responding by scrambling to find alternative supply streams. Retailers are lobbying, with little success, for exemptions for specific product categories. Consumers are left to sit back and wait for the situation to unfold, all the while bearing the brunt of increased product costs.

As Dan Harris of the China Law Blog points out, the question may not be when the trade war will end, but rather, **how far will the trade war spread**?

At this point, China's best strategy appears to involve waiting, something it has historically done far better than the U.S. As we've pointed out in the past, the technocrats in Beijing appear almost entirely ambivalent to the short-term pain felt by their population. China's strategic ambivalence is a unique luxury afforded by Xi Jinping's "President for Life" designation.

With the 2020 U.S. elections fast approaching, China's best bet may be to contribute to the conditions that lead to the sort of economic slowdown that could doom Trump's electoral odds. The potential benefits of such a strategy are two-fold: (1) The Trump administration feels the pressure and caves on a trade deal prior to the election; or (2) Trump loses in 2020 and Beijing gets a Democrat President who may be eager to seize the symbolic victory of having ended the trade war.

Of course, there's a third option: China turns up the heat, Trump still manages to win in 2020, and then all hell really breaks loose.

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intermediary country in an effort to avoid tariffs. As an attorney, let me assure you: this is super, duper illegal. Run as fast as you can from any person, company, or firm advising you that this is a viable option.

BAMKO: While China remains critical to both our short and long-term sourcing strategy, this trade war has acted as an accelerant in our efforts to expand and diversify our global supply chain. Over the last two years, we've made significant efforts to strengthen and expand our supply chain throughout Asia, as well as in North, Central, and South America. At of this writing, roughly 50% of our overseas manufacturing is done outside of China and includes rapidly expanding footprints in countries like India, Vietnam, and Bangladesh.

While efforts to diversify our supply chain have proven serendipitous as the U.S.-China trade war has escalated, the genesis of this effort goes back years before the start of any trade tensions. We have long found that our best options for products such as apparel, totes, duffels, drinkware, and toys are often found outside of the Middle Kingdom.

Of course, there remain certain product categories, such as consumer electronics, where China remains the undisputed king of the hill. For those, BAMKO remains our industry's leader in China sourcing. We are simply better equipped to mitigate the effects of tariffs through strategic sourcing, product development choices, and engineering efficiencies.

Joshua White is BAMKO's General Counsel and SVP, Strategic Partnerships. Mr. White is an expert in helping BAMKO's clients navigate the complex landscape of law and public policy in China and international commerce. Mr. White has a degree in Political Science from the University of Southern California and a Juris Doctorate from the UCLA School of Law.